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In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 741

CHASE BRASS AND COPPER CO., INCORPORATED,

Appellant,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Appellee.

On Appeal from the Court of Appeal of California, First Appellate District

Jurisdictional Statement

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On Appeal from the Court of Appeal of California, First Appellate District

Jurisdictional Statement

This is an appeal from a state court decision holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with that of its parent, Kennecott Copper Corporation, and with that of Kennecott Sales Corporation and Kennecott Wire and Cable Co. Appellant submits this Statement to show that this Court has jurisdiction of the appeal and that substantial questions are presented.

OPINIONS BELOW

The opinion of the Court of Appeal of California, First Appellate District, affirming in part and reversing in part a decision of the trial court, is reported at 7 Cal. App. 3d 99, 86 Cal. Rptr. 350, and is set forth in Appendix A. The opinion of the Court of Appeal on denial of petition for rehearing is reported at 10 Cal. App. 3d 496, 87 Cal. Rptr. 239, and is set forth in Appendix B. The California Supreme Court denied a hearing without opinion. The Superior Court for the State of California in and for the City and County of San Francisco, in giving judgment for appellant, filed no written opinion. Its finding of facts and conclusions of law are set forth in Appendix C.

JURISDICTION

This suit for refund of state corporate franchise taxes was brought pursuant to section 26102 of the California Revenue and Taxation Code and section 401 of the California Code of Civil Procedure. The California Superior Court in and for the City and County of San Francisco held that Chase Brass and Copper Co., Incorporated (Chase) was not unitary with any other corporation, should be taxed only by its own net income, and was therefore entitled to the claimed refund. This decision was reversed in part by the California Court of Appeal, First Appellate District. The final judgment of the Court of Appeal was entered on April 29, 1970. Opinion on Denial of Petition for Rehearing was filed on May 27, 1970. The Supreme Court of California denied Chase's timely Petition for Hearing on June 24, 1970, without rendering an opinion. A notice of appeal to this Court was filed in the Court of Appeal on July 10, 1970. A copy of that notice is set forth in Appendix D.

Jurisdiction to hear this appeal is conferred on this Court by 28 U.S.C. § 1257(2) and is supported by decisions in *Norfolk & Western Ry. Co. v. Missouri Tax Comm.* 390 U.S. 317; and *Hudson Distributors v. Eli Lilly & Co.*, 377 U.S. 386.[1]

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The Commerce Clause of the Constitution of the United States (Art. I, § 8, cl. 3) and the Due Process Clause of the Fourteenth Amendment are set forth in Appendix E.

The pertinent sections of the California Revenue and Taxation Code, sections 25101, 25102, 25103, 25104, and 25105, are set forth in Appendix E.

QUESTIONS PRESENTED

1. Can two commonly owned but separately incorporated and separately integrated businesses, only one of which does business in the taxing state, be treated by that state as unitary with each other and consolidated for formulary apportionment, without repugnancy to the Due Process and Commerce Clauses, where the sole basis for treating them as unitary with each other is minor common cost saving opportunities from which each corporation benefits, and common control of major policy, but the findings of fact are that the manner in which they operate does not cause either corporation to receive income actually earned by the other, and the widely differing margins of profit of the two types of business necessarily cause the averaging effect of the formula to shift immense amounts of income from the more profitable business to the less profitable one.

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1. In the latter case (see 377 U.S. at 389, n. 4), collateral issues not finally resolved did not prevent this Court's review, and should not in this case. See Appendix H, pp. 51-60, where we develop the maximum favorable resolution of the taxpayer's case, and show even this to be unconstitutional.

2. If the answer to the first question would ordinarily be affirmative, is a state's consolidation of a parent and subsidiary corporation for purposes of the state's apportionment formula repugnant to the Due Process and Commerce Clauses, where only the subsidiary can be taxed because the parent does no business in the taxing state, and where the findings of fact are that the effect of the consolidated formula was "to assign to" the subsidiary "income earned by the income earning activities of" the parent, and the extent of the distortion produced by the consolidated formula is to multiply the subsidiary's income sevenfold.

3. Is it repugnant to the Due Process and Commerce Clauses for California to impose a privilege tax for the exercise of the corporate franchise on a foreign subsidiary corporation which does business within its borders, measured by the net income of the foreign parent corporation which the state stipulates did not do business within its borders, where each corporation operates an integrated business of its own, the transactions between them are governed by the standards of the market place, and there are no circumstances warranting the disregard of the corporate entity of either.

4. Is discrimination repugnant to the Due Process Clause present where California imposes a heavier tax burden on a foreign corporation operating an integrated business within and without the state, than it imposes on business competitors, merely because the foreign corporation is a subsidiary of another foreign corporation, and in the absence of intercorporate abuses and also in the absence of facts showing that the status of the taxed corporation as a subsidiary gives it economically measurable advantages over its independently owned competitors.

STATEMENT OF THE CASE

A. Material Facts.

The facts of this case were not fully stated in the opinion of the Court of Appeal, and are here supplemented by references to the Findings of Fact (Appendix C) and portions of the Stipulation of Facts (Appendix F).[2] The record below also included the uncontradicted testimony (See App. 5) reflected in part in the Findings.

Chase, a Connecticut corporation organized in 1909, manufactures brass, bronze, and copper rod, wire, sheet, and tube. Manufacturing is done in plants located in Connecticut and Ohio. Chase is qualified to do business and is doing business in 25 states, including California. In 1929, its stock was acquired and has been since owned by Kennecott Copper Corporation (Kennecott). (App. 29)

The parties stipulated:

> "[T]he President of Chase . . . directed the affairs of Chase. His time and attention were given to Chase; he was not responsible for the business operations of Kennecott or of any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale." (App. 34.)
>
> "[D]ay-to-day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day-to-day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various sub-ordinate employees of the subsidiaries. . . ."
> (App. 33)

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2. Hereafter appendix references are to App., followed by the page number.

Both the president and executive vice president of Chase came to Chase from independent companies. (App. 41.)

The taxes at issue in this appeal involve the income years 1954, 1955 and 1956. They are upon Chase's privilege of exercising its franchise within California and are to be measured by Chase's net income derived from California. Rev. & Tax. Code § 23151.

Where a corporation's net income is derived from sources within and without the state, California requires apportionment to determine the income derived from sources within California. Rev. & Tax. Code § 25101. In its California tax return, Chase reported its entire net income as reflected on its books of account, and computed its California income on the basis of the traditional three-factor apportionment formula, which is the average of the ratios of property, payroll and sales within the state to those outside the state. (App. 2.) For neither state nor federal tax purposes did Chase or Kennecott, the parent, file consolidated returns. (App. 48.)

The Franchise Tax Board redetermined Chase's California income by consolidating its income with that of Kennecott, Kennecott Sales Corporation (Kennecott Sales), Kennecott Wire and Cable Co. (Kennecott Wire), Bear Creek Mining Co. (Bear Creek) and Braden Copper Co. (Braden). (App. 2.) The effect of this redetermination was to multiply both Chase's California income and its overall corporate income thirteen-fold. The Superior Court disapproved the consolidation and gave judgment for appellant. The Court of Appeal sustained the consolidation of Chase with Kennecott, Kennecott Sales and Kennecott Wire, but not with Braden and Bear Creek.

Kennecott, a New York corporation, mines, smelts and refines copper, gold, silver, and molybdenite. It does no

business in California. (App. 2.) Kennecott, through Kennecott Sales, sells fungible copper to numerous fabricators. (App. 44-45.) Approximately 20% of its total production of copper is sold to Chase and 4% to Kennecott Wire; the remaining 76% is sold to other customers. (App. 39.) Chase's two major competitors together purchased approximately as much of Kennecott's output of copper as Chase did, representing between 50% and 60% of their copper requirements. (App. 19.) Chase's purchases from Kennecott constituted approximately 80-84% of the copper purchased by it. (App. 3.)

Kennecott Sales, a New York corporation, took over in 1934 the sales activity theretofore assigned by Kennecott and Braden to an independent sales agency. No sales are made in California. (App. 3, 17, 37.) Kennecott Sales charges Kennecott a commission on each sale (App. 3), and sells the copper to Chase and others at the going market price for fungible refined copper (App. 10, 44). For the years at issue, Kennecott Sales paid to the State of New York a tax upon its entire corporate net income and New York did not allocate any part of that net income to other states. (App. 48.)

Kennecott Wire, a Rhode Island corporation, manufactures copper rod, wire and cable for transmission of electricity. Its stock was purchased by Kennecott from outsiders in 1935. It uses refined copper which it purchases from Kennecott Sales. Its sales operations in California are largely handled by Chase. Kennecott Wire did no business in California during the relevant years. (App. 3, 29-30, 32.) The president of Kennecott Wire was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete line and staff organization, which under his direction, carried out

the fabricating, pricing, selling (except as for that part handled by Chase), purchasing, record keeping, employee relations, and all other customary and necessary functions of a modern corporation engaged in fabricating and selling on a wide scale. (App. 34-35.) For the years at issue, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income and Rhode Island did not allocate any part of that net income to other states. (App. 48).[3]

The trial court, on the basis of evidence said by the Court of Appeal to be uncontradicted (App. 5), found as ultimate facts (App. 20):

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden, and Kennecott Sales . . . .
>
> "Chase's business activities are not so interrelated with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business con-

3. Braden, a Maine corporation, operated copper mines in Chile. Braden sold fire refined copper. It was a Western Hemisphere Trade Corporation for federal income tax purposes and ordinarily sold only to the Chilean government or on the world market. In the years at issue, due to United States copper shortages, it did sell, through Kennecott Sales, in this country. Chase was a buyer. (App. 2.)

Bear Creek, a Delaware corporation, explored for metals in California during the years at issue but made no significant discoveries. It is the third company in the mining group composed of Kennecott, Braden, and Bear Creek. (App. 2-3.)

The board included Braden and Bear Creek in the consolidation, but both courts excluded them. (App. 11.) The status of these two corporations is not now an issue.

tact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent market place.

"Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership."

It held that on these facts Chase was not unitary with any other corporation (App. 21-22), and rendered judgment for Chase. (App. 22.)

The Court of Appeal reversed the decision of the trial court in part, holding that the combined reporting of Chase, Kennecott Wire, Kennecott Sales and Kennecott was proper (App. 6-9), because:

1. Kennecott does "minor" purchasing of some supplies for Chase;

2. Although Chase maintains its own trade name, trademark, advertising program and budget, its advertisements often contain a statement that Chase is a subsidiary of Kennecott;

3. Although Chase and Kennecott keep separate books of account, the two use the same accounting firm (the court mistakenly said that they also file consolidated tax returns, though the stipulated fact (App. 48) is to the contrary);

4. Although Chase has its own legal staff and on occasion employs its own outside counsel, the presentation of the protest of Chase before the Franchise Tax Board in this case was handled by Kennecott employees (the Court of Appeal did not refer to testimony that the reason Kenne-

cott had its employees handle the protest was that it felt its income was being taxed (RT 54);

5. In 1955 Kennecott made a loan to Chase, in the amount of ten million dollars, for the rehabilitation of a plant severely damaged by flood, although the prime bank rate of interest was charged and the loan including interest was repaid within four years (the Court of Appeal did not refer to the fact that the effect of the flood was to close the plant for portions of two of the years involved here and to lower greatly Chase's margin of profit);

6. Although the pension plans for hourly employees were separate, Kennecott administers a common retirement plan for salaried employees;

7. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters;

8. Salaries above $15,000 for employees of Chase and Kennecott Wire were submitted to Kennecott's salary committee for review;

9. Chase warehoused and sold some of Kennecott Wire's production of wire mill products; and

10. Chase annually purchased about 20% of Kennecott's copper output, all of the purchases of which were at prevailing market prices.

The Court of Appeal concluded (App. 10-11):

> "The fact of the sales alone, however, whether especially advantageous to Kennecott or Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary."

The Court of Appeal held that Chase was not unitary with either Braden or Bear Creek, but was unitary with

Kennecott, Kennecott Sales and Kennecott Wire. It remanded the case to the trial court for the task of calculating the limited refund due under its decision. (App. 11.) Our calculations are that if all doubts are resolved in favor of the taxpayer, the additional income allocated to Chase on the consolidated basis will still be seven times that shown by its own records. (See footnote 8, p. 22, *infra*.)

B. Stage at Which Federal Questions Were Raised.

The federal questions presented here were raised by the pleadings in the trial court. The complaint alleged that the denial of the claim for refund was "erroneous, contrary to federal and California law, and unconstitutional under both the commerce clause and the due process clause of the United States Constitution. . . ." The trial court concluded that Chase was not engaged in a unitary business under California law and specifically did not reach Chase's constitutional claims. The issues not reached were enumerated in the trial court's Conclusions of Law (App. 21-22); all of them were raised in the briefs before the Court of Appeal.[4] The Court of Appeal, in reversing the judgment below in part, did not explicitly answer the arguments that the result it reached was repugnant to the federal Constitution. The Petition for Rehearing to the Court of Appeal requested the court to rule explicitly instead of tacitly on the issues arising under the Due Process and Commerce Clauses. In its opinion on denial of rehearing the Court

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4. Chase's brief on appeal states in summation:

"In the preceding pages of our brief, we have demonstrated that appellant's actions have violated several federal constitutional principles. The one most flagrantly violated is the due process (Amendment XIV) and commerce clause (Art. I, section 8, co. 3) principle that a state must have some minimum connection with what it attempts to tax [citations omitted]." Respondent's Brief, p. 235.

again refused to answer the constitutional arguments. Chase's arguments under the Due Process and Commerce clauses were again raised in the Petition for Hearing in the California Supreme Court, which was denied.

SUMMARY OF ARGUMENT

1. California's franchise tax is subordinate to the federal constitutional principle that when levied on foreign corporations it may not be measured by values derived from other states. *Wallace v. Hines*, 253 U.S. 66; see also *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317. This Court has, as the foregoing cases demonstrate, permitted the use of an apportionment formula to allocate net income and other taxable values between states in which a unitary business operates, so long as the effect is not to tax substantial extraterritorial values which other states may more properly tax.

This case presents the question whether a foreign parent corporation not doing business within the taxing state is unitary, within the concept derived from this Court's decisions, with its foreign subsidiary which is doing business in the taxing state, where each corporation operates its own integrated business. Each of these businesses is unitary within itself, but they are not unitary with each other, for a number of reasons. As the trial court found, there are no transactions between them to blur the normal ability of an integrated business to ascertain its own corporate net income. The minor cost saving common functions produced savings from which each corporation benefitted and which each took into account in its own separate net income, but the California Court of Appeal found that these minor common functions plus common control of major policy made the two separate businesses unitary with each other. The California Court of Appeal believed, quite er-

roneously, that these minor consequences of common ownership justified shifting income between corporations and hence from outside California to within the state.

The California court ignored the facts before it which showed that the business California could not tax had a margin of profit more than ten times as great as that of the one it could tax, and also ignored the finding of fact of the trial court that that large margin of profit was earned exclusively by the nontaxable business and not by the out-of-state parent's imposing its will on the taxable subsidiary.

The necessary effect of what the California court did was to employ the unitary concept to combine two separate and distinct businesses which can readily determine their respective incomes, so as to shift income between them in a major shift not explainable by economics, and to impose a tax on income not possibly attributable to the taxing state.

The question whether this perversion of the unitary principle is repugnant to the Due Process Clause and the Commerce Clause is a substantial federal question.

2. Even in a single unitary business, an apportionment formula which does not achieve "rough approximation" is unconstitutional. *International Harvester Co. v. Evatt*, 329 U. S. 416; *Wallace v. Hines*, 253 U.S. 66; *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317. The California Court of Appeal ignored this principle and even refused to discuss it, although the record before it showed that the board's assessment method multiplied taxable values thirteen-fold over the actual values.

Even after correction for the removal of the errors in this assessment which the Court of Appeal agreed did exist, Chase's corporate net income was multiplied seven-fold beyond actual, by the magic of consolidation with its parent

and reallocation between them by a rigid formula. The formula assumes something contrary to the record, that the two businesses are equally profitable in ratio to property, payroll and sales. Where, as here, the respective margins of profit are inherently different, and a major plant of the less profitable corporation was closed for a substantial portion of two of the three years, a reallocation of net income between them by a rigid formula which assumes equal profitability can readily produce distortion, and here it did so by a seven-fold multiplication of actual corporate income.

A seven-fold multiplication is not any sort of approximation, rough or otherwise. It is blatant taxation of immense extraterritorial values. Even a business as traditionally unitary as the railroad business cannot be taxed by the unitary formulary method where such a result follows from it. *Wallace v. Hines; supra, Norfolk & Western Ry. Co. v. Missouri Tax Comm.; supra.* The refusal of the California Court of Appeal to observe this limitation is contrary to those decisions of this Court and therefore presents a substantial federal question.

3. A congressional committee has reported that California insists on litigating its right to require what it calls a combined report, and that that insistence may bring California into headlong conflict with Public Law 86-272 (15 U.S.C. §§ 381-384). (H.R. Rep. No. 1480, 88th Cong., 2d Sess. 245 (1964).) Under that act, California cannot tax Kennecott, Kennecott Sales or Kennecott Wire, because none of them has either property or employees in California. Nor can California tax them consistently with the Due Process Clause.

California does not claim it can tax them. What it claims is that it can circumvent its lack of jurisdiction to tax them by the guise of attributing ownership of their net income to Chase and taxing it there.

The question whether lack of jurisdiction can be thus circumvented is a substantial federal question under the Due Process Clause, and, because of its effect on the regulation of commerce adopted in Public Law 86-272, under the Commerce Clause as well.

4. The tax involved is a corporate franchise tax measured by net income, not a tax on the net income itself. In sustaining California's right to measure this tax by tax-exempt interest, this Court has said that the distinction is "one of substance, not of form". *Pacific Co. v. Johnson,* 285 U.S. 480, 490. The reality of the distinction was again emphasized in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602. Yet here California is seeking to measure its franchise tax by values belonging not to this franchise but to other franchises not within California's jurisdiction to tax.

No claim is made that the corporations so conducted themselves that they disregarded their own corporate separateness, and the facts found, and those discussed in the opinion below, would negate such claim.

Nor is Chase's franchise enriched by what its parent owns.

This Court has held that when Congress confers or limits jurisdiction it does not mean to authorize disregard of corporate entities where the corporations themselves have not done so. *Cannon Mfg. Co. v. Cudahy Packing Co.,* 267 U.S. 333. Public Law 86-272, referred to above, should be so construed.

The leading case in the franchise tax field is *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). It supports our views. It did not reach this Court, but it is a particularly persuasive authority because the author of the opinion later became a member of this Court.

A substantial federal question is presented, accordingly, about the constitutional right of states taxing multi-state businesses in a manner to tax corporate franchises and simultaneously ignore them.

5. The Due Process Clause prohibits discrimination. *Bolling v. Sharp*, 347 U.S. 497; *Detroit Bank v. United States*, 317 U.S. 329. The prohibited discrimination here is taxing a subsidiary more heavily than its independently owned competitors.

Undoubtedly a subsidiary may enjoy benefits from its subsidiary status denied to its independent competitors, but none are shown to exist in the record here. On the contrary, the trial court found that in its dealings with Chase the parent treated Chase and its independent competitors alike.

The record identifies some of Chase's competitors, so we are not left to speculation about their existence, or the discrimination in their favor California's tax involves. The speculation this case invites is the existence of any economic justification for that discrimination. No such justification appears.

The decision below thus raises a substantial question about the validity of the discrimination against Chase and in favor of its independent competitors under the Due Process Clause.

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

The federal questions arise under the Due Process Clause (Amendment XIV) and the Commerce Clause (Art. I, Sec. 8, Cl. 3). Although these federal questions constituted our major premise below, no reference is made in the opinion of the Court of Appeal either to them or to the decisions of this Court interpreting and applying them. In denying our petition for rehearing, the court finally responded to our insistence that decisions of this Court con-

trolled the issues presented by referring to one of them (*Norfolk & Western Ry. Co. v. Missouri State Tax Comm.*, 390 U.S. 317) as irrelevant. Other than this reference, nothing in the opinion suggests that California is not an independent nation, free to adopt its own standards of taxation without subordination to principles of the federal Constitution.

Yet this Court has declared the existence of federal constitutional principles to which California and the other states must yield. The California tax is a corporate franchise tax, and this Court has held repeatedly that a corporate franchise tax is repugnant to the Commerce and Due Process Clauses as applied to a foreign corporation such as Chase if measured by extraterritorial values. *Wallace v. Hines*, 253 U.S. 66; *Airway Electric Appliance Corp. v. Day*, 266 U.S. 71; *Southern Ry. Co. v. Kentucky*, 274 U.S. 76; *Butler Brothers v. McColgan*, 315 U.S. 501, 506-507, (cited below only by its state citation); *International Harvester Co. v. Evatt*, 329 U.S. 416. The same rule applies to other excise or privilege taxes (*Frick v. Pennsylvania*, 268 U.S. 473), to capital stock taxes (*Pullman's Palace-Car Co. v. Pennsylvania*, 141 U.S. 18), and to property taxes (*Fargo v. Hart*, 193 U.S. 490, and *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317). The propriety of measuring the tax by extraterritorial values is the federal issue presented but not considered by the Court of Appeal.

Because the decision below conflicts with applicable decisions of this Court, the federal questions are substantial.

I. A. This Court has never held two integrated businesses such as are presented here to be unitary with each other, and it should not tolerate such a decision. Chase conducts a multi-state integrated business in competition with others, all of whom, like Chase, buy refined copper from Kennecott. Chase buys from 80 to 84 percent of its

copper requirements from Kennecott (App. 3), but its competitors buy as much as 70 percent from the same source. (App. 18-19.) Chase and its competitors buy at the same price and on the same terms and when copper supplies are short subject to the same allocation of copper by Kennecott. Chase and its competitors buy other metals, none of which come from Kennecott, to alloy with copper, thus producing bronze and brass. From these alloys are fabricated the products they sell. (App. 3, 10, 32.)

Kennecott does not own the plants or sales facilities Chase uses. Chase owns them. What Kennecott does is to own vast mines and reduction facilities, all outside California, from which it produces its own end product, refined copper. This refined copper it sells to all its customers, only one of which is Chase, at the same price and on the same conditions. While Chase's purchases amounted to 20 percent of Kennecott's output, ten customers bought most of its output and a large number of smaller customers bought a total of only about 25 percent of it. (App. 44-45.) Hence large purchases by single customers are a characteristic of Kennecott's business. Thus Revere Copper & Brass Company, a competitor of Chase, was also a large Kennecott customer and bought in excess of 50 percent of its copper requirements from Kennecott. Together with General Cable it bought as much copper from Kennecott as Chase did, although the largest single shareholder of both Revere and General Cable was American Smelting and Refining Company (Asarco), itself a copper producer. (App. 25)

In the years involved, copper was in short supply and was allocated by the producers among their customers. To augment the supply, the United States suspended the import duty, thus admitting competitive foreign copper for fabricators to buy.

The two businesses were operated separately, each by one corporation. Chase had two factories, one in Connecticut and one in Ohio, and its staff and executives were there. (App. 29.) Kennecott's principal office is in New York (App. 29), and its mines and reduction facilities are in Utah, Arizona, Nevada and New Mexico (App. 31). Chase does business in California, whereas Kennecott does not. (App. 2-3) Chase had a complete line and staff organization headed by a president, which ran its business and had no role in Kennecott's business. (App. 34.) It had its own board of directors of eight members, five of whom were Chase officers employed in Connecticut. Three members were Kennecott officials, and none of them attended a Chase meeting in the years involved. Similarly Kennecott had its own organization, to which Chase did not contribute any of its personnel. (App. 33-34.)

Chase and other fabricators characteristically have much smaller margins of profit than the mining companies (App. 61-63), and this disparity prevailed between Chase and Kennecott. The latter had one of the copper mining industry's highest margins of net profits to sales (45.4%), whereas Chase was hobbled by a strike and a flood and managed only a 2% margin. To combine the two and apportion between them by a common formula obviously has the effect of shifting profits from Kennecott to Chase.[5] Since Kennecott's property and business are entirely outside California, this procedure necessarily allocates income from other states, which have the right to tax it, into California for a second tax.

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5. Implicit in the mathematics of an apportionment formula is the assumption that all property, payroll and sales in the apportionment unit will be equally productive of net income. Therefore when the two businesses combined into a single apportionment unit are greatly different in profit margins, the necessary effect is to average, which means to take from one and allocate to the other.

The foregoing is a necessarily truncated statement of the facts which led the trial court to find as facts that the formula shifted income to Chase from other corporations which had earned it, and that the relationship between Chase and Kennecott did not permit either to profit from the other in any way not fully reflected in their books of account. (App. 20.)

What the California Court of Appeal has held is, therefore, that the net income of two corporations each conducting its own integrated business, but only one doing so in California, and each with a corporate net income reflected in its books, must be consolidated and then apportioned back to each corporation by formula, because under California concepts they are unitary with each other. A reading of the opinion will show that the unitary aspects relied on are minor and more concerned with the existence of power than with its actual exercise.

The concept of a unitary business was borne of an effort to permit a state to tax the full value of the property and operations of a multi-state enterprise within its borders. A limitation this Court has enforced (see *Norfolk & Western Ry. Co. v. Missouri Tax Comm.*, 390 U.S. 317, the latest relevant decision from this Court where the earlier ones are collected) is that the formula may not appropriate to the taxing state substantial values derived from and taxable by other states.

The present case is the first one presented to this Court in which a state has combined two corporations each with its own complete, integrated business, and has reallocated their income between them by formula and then apportioned the income thus artificially assigned to the only one doing business in the taxing state.[6]

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6. California does this by a simplified mathematical process which is the mathematical equivalent. See App. 51-60 where we demonstrate how the California mathematics works.

In prior decisions sustaining a formula's use, geographical allocation of the income or property of a single integrated business was presented.[7] That is not the issue here; Chase filed its returns on that basis, for it employed the administratively devised three-factor formula and apportioned some of its corporate net income to California by that means. The board combined Chase's net income with that of its parent Kennecott, its sister Kennecott Wire, and its sisters Braden and Bear Creek. The trial court disapproved the entire consolidation, on findings of fact that it produced distortion (App. 20), but the Court of Appeal, while not denying the existence of the distortion found as a fact, reinstated the consolidation as to Chase, Kennecott and Kennecott Wire, finding them unitary as a matter of law.

We need not concern ourselves at this point with the facts about Kennecott Wire, which like Kennecott did no business in California. It is the allocation of Kennecott's huge income to Chase which produces the bulk of the distortion and which is vividly unconstitutional. The results of the Court of Appeal's legal conclusion of unity between these two separate businesses are to multiply Chase's net income seven-fold, and to confer on it the capacity to earn 46.7% as much income as Kennecott because it buys 20% of Kennecott's output and is owned by Kennecott,

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7. The California conception of "a unitary business" which requires formulary allocation (apportionment) for geographical allocation of net income has been criticized. Hellerstein, "Recent Developments in State Tax Apportionment," 21 Nat.Tax J. 487, 497-503 (1968); and compare Keesling & Warren, "The Unitary Concept in the Allocation of Income," 12 Hastings L.J. 42, expressing the same thoughts as Professor Hellerstein, written prior to the decision in *Superior Oil Co. v. Franchise Tax Board*, 60 Cal. 2d 406, 34 Cal. Rptr. 545 (1963), which Professor Hellerstein criticized.

whereas due to flood and strike it actually earned 4.45% as much.[8]

The indicia of unity the Court of Appeal found are minor and in some instances pure speculation. They cannot possibly account for or justify a seven-fold increase in the profits of the less successful unit in the combination.

The court agreed that the opportunities for unity in a vertically integrated enterprise are few but after concluding that it was dealing with such "an enterprise" magnified all it could find. The court dwelt on the stipulation that Kennecott did some "minor" purchasing for Chase, and that in some instances some common insurance coverage was obtained.[9] While recognizing that Chase had its own trademark, advertising program and budget, the court observed that Chase's advertisements "often contain a statement that Chase is a subsidiary of Kennecott", and that when Chase

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8. If every mathematical issue left for resolution on remand is decided in Chase's favor, the shifting of income between corporations accomplished by the Court of Appeal will be as follows (the schedule below summarizes the three-year cumulative income shifting detailed at App. 56-60):

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total	(3) Net Income Per Board's Formula	(4) Percentage Per Board's Formula	(5) Column 3 as Percent of Column 1
Chase	$ 11,597,596	4.12%	$ 88,269,277	31.36126%	761%
Kennecott Wire	8,979,615	3.19	3,897,805	1.38485	43
Kennecott	260,413,229	92.52	189,292,562	67.25389	73
Kennecott Sales	469,204	0.17	(entirely eliminated)	—	—
Total	$281,459,644	100.00%	$281,459,644	100.000 %	

9. The court conceded that "There was no intercompany coverage on basic industrial policies such as fire, fire use and occupancy, workmen's compensation, public liability, automobile liability and fire, sickness and accident, hospitalization and surgical, and certain types of bonds." Seemingly the court thought it unimportant that in major insured areas there was no intercompany coverage, but actually that is far more significant than the minor common coverage.

uses an agency it uses the same one Kennecott uses. The court even observed that both use the same accounting firm. It commented that Kennecott employees handled Chase's administrative protest in this case, without observing that Kennecott's assistant controller testified that that occurred because it was Kennecott's income by which the agency was attempting to tax Chase. (R.T. 54.) The ultimate was reached when the court referred to Kennecott's loan to Chase at the prime bank rate of interest, made to enable Chase to rebuild its flood-damaged plant, as "substantial evidence of unity of operation" because it was "advantageous to the over-all management." If everything "advantageous" justifies a consolidation of two separate, integrated businesses and a multiplication of the income of the only one the state can tax, then mere investment in a minority position in another corporation would justify consolidation, because the investment would not have been made had it not been advantageous.

As an obvious anti-climax, the court referred to the common retirement plan for salaried employees, without observing any irony in its treatment of two businesses as unitary with each other because of the fact that when employees cease to work in either they receive the same retirement benefits.

These were the indicia of unity of operation the Court of Appeal found. All are minor and are vastly outweighed by the dominant instances of separate operation. None can shift income or expense from one to the other, although some can minimize expenses, a benefit both shared. The critical question, though, since the combined formula shifts income, is whether it compensates for some tendency in the facts deemed unitary to shift income or expense. Containing no such tendency, those facts do not justify what was done by the court.

The same is true of the matters the court labelled "unity of use." The president of Chase "reported to the president of Kennecott with respect to major policy matters." The Court of Appeal said that " 'major policy matters' are what count. . . ."[10] Later after stating that Kennecott's sales of copper to Chase do "not determine the business to be unitary," the court reiterated that all the minor circumstances reviewed above, "and particularly those relating to control of major policy, together with the subject of sales", make Kennecott and Chase unitary.[11]

No major policy is suggested which could have shifted income or expense between Kennecott and Chase. Nor does the Court of Appeal suggest this was done. The absence of that relevant fact destroys any possible justification for what California has done.

The power to control major policy is a consequence of ownership. It is always where ownership is. Heretofore formulary allocation has been denied on constitutional grounds when common ownership was all that was present. *Fargo v. Hart*, 193 U.S. 490; *Southern Ry. Co. v. Kentucky*, 274 U.S. 76; and cf *Butler Bros. v. McColgan*, 315 U.S. 501, 509, where this Court noted, in sustaining the application of the California formula to a unitary business, that "no showing has been made that income unconnected with the unitary business has been used in the formula."

Common ownership does not convert unconnected properties to unitary status, the foregoing cases hold, and that

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10. The court also found significance in Kennecott's prerogative of reviewing all Chase salaries about $15,000. This, a normal control of a board of directors, is an indicia of Kennecott's ownership of Chase, but nothing more.

11. The court's conviction that sales alone are not enough to make two businesses unitary is emphasized by its agreement that Braden and Chase are not unitary, although Braden was the source of some Chase copper.

is all there could be here. To tax Chase on Kennecott's income, which Kennecott earned in its own business, is at least as offensive to the Due Process and Commerce Clauses as apportioning income from investments unrelated to the unitary business, and this is not permissible. *Fargo v. Hart, supra.*[12]

The federal question is substantial and has not heretofore been presented by the action of any state.[13] If tolerated the California technique can be expected to be employed by other states, with resultant multiple taxation burdening commerce, and burdensome taxation of income not earned in the taxing state.

II. A. In paying its fleeting respects to the only case from this Court to which it referred (*Norfolk & Western Ry. v. Missouri Tax Comm.*, 390 U.S. 317), the Court of Appeal distinguished it on grounds which will not withstand analysis. The Court of Appeal dismissed it as presenting a narrow factual issue, and further as being "far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted." (App. 12-13.)

It is obvious that this Court did not review the *Norfolk & Western* case in order to settle a narrow factual dispute.

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12. A quixotic element in this case is that there are real unitary aspects in the relationship between Kennecott and Asarco. Asarco smelted Kennecott's ore from its Arizona and Utah mines, and refined the smelter product from its Nevada mine and at times from its Utah and Arizona mines as well. But Asarco and Kennecott are entirely separately owned, so California recognized that they were able to distinguish the net income of each from the other, and that the consolidation-formula technique need not be applied to them in order to determine Asarco's net income from California. (App. 45-47.)

13. The other states which have considered comparable cases have held to the contrary. *Skelly Oil Co. v. Commissioner*, 269 Minn. 351, 131 N.W. 2d 632 (1964); *Square D Co. v. Board of Tax Appeals*, 415 S.W. 2d 594 (Ky. 1967); *Gulf Oil Corp. v. Clayton*, 267 N.C. 15, 147 S.E. 2d 522 (1966).

It is only slightly less obvious that the interstate railroad business involved in that case was a unitary business, since interstate railroads are the prototype unitary business to which less clear cases are analogized. It follows that if the Court of Appeal is correct, contrary to what we urge above, that Chase and Kennecott combine together to conduct a single unitary business, then the *Norfolk & Western* case has a message this Court intended be applied to it.

The *Norfolk & Western* case did two things. First it restated a doctrine long ago established: that even in the instance of a unitary business a formula which is normally reasonable is subject to attack on constitutional grounds where on the facts of a particular case it seriously overstates the values within the taxing state. This Court cited *Wallace v. Hines*, 253 U.S. 66, where a state franchise tax applied to an interstate railroad was held invalid because its apportionment formula failed to take into account substantial differences in local conditions from those in other states. There Mr. Justice Holmes had said for the Court (253 U.S. 66, 69):

> "The purpose is not to expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the State."

Not since 1931 had this Court reminded the states that that principle is still viable. *Hans Rees' Sons v. North Carolina*, 283 U.S. 123. It was restated and enforced in 1968 in *Norfolk & Western*.

Second, this Court announced a corollary principle. It held that a generalized assumption of enhancement of values due to unitary operation would not save a formula where the taxpayer produced evidence tending to show the formula allocated to the taxing state substantial values derived from other states, and therefore where such evidence

was produced the state must rebut it by evidence supporting the values produced by the formulary apportionment.

The opinions below show that both messages have been lost on the California Court of Appeal and its Supreme Court. The Court of Appeal held that the two businesses together formed one unitary business and therefore the formula must be used. Of the issue raised by the *Norfolk & Western* case, the *Hans Rees* case before it, and before it *Wallace v. Hines,* and other cases, it said nothing. Not a hint is in the opinion that there was evidence before the court that the effect of the formula was to multiply the California values at least seven-fold. Nor is there any reference to the evidence of source of income and of earning power, which evidence led the trial court to find as a fact (App. 20):

> "The apportionment formula used by defendant operates to assign to Chase income earned by the income earning activities of Kennecott, Braden and Kennecott Sales..."

A seven-fold increase in Chase's corporate net income by formulary allocation produces a seven-fold increase in that allocated to California by the same formula. By contrast, the multiplication of taxable values this Court found objectionable in *Norfolk & Western* was only two to one. The California courts are inclined to quote this Court's language in *International Harvester Co. v. Evatt,* 329 U.S. 416[14] that "rough approximation is sufficient," whenever faced with evidence that a formula has distorted, but a seven-fold multiplication of taxable values is not any sort of approximation. It is an unconstitutional seizure of vast values

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14. *El Dorado Oil Works v. McColgan,* 34 Cal. 2d 731, 215 P. 2d4 is the first such instance, and *Montgomery Ward & Co. Inc. v. Franchise Tax Bd.,* 6 Cal. App. 3d 149, 85 Cal. Rptr. 890 (on appeal to this Court, No. 592, Oct. Term 1970), the latest out of 7 citations.

earned in and taxable by other states. If a two-fold multiplication is invalid, as this Court held in *Norfolk & Western*, then a seven-fold multiplication is *a fortiori*.

The California court here did not claim that the result was "rough approximation." It did not even refer to the existence of evidence of distortion, or the finding of the trial court to that effect. It considered them legally irrelevant, in spite of *Norfolk & Western*. It said there were some indicia of unitary character and a formula therefore must be used, and in denying the rehearing it also declined to mention the evidence before it, although distinguishing *Norfolk & Western* on the ground that there was evidence of distortion in that case. The distinction offered is unconvincing. It really amounts to saying that a case stating the rules Missouri must follow contains no lessons for California.

Yet the court had before it both the findings of fact of the trial court, and the evidence relied on below which even the Court of Appeal acknowledged to be uncontradicted (App. 5), which showed that Chase could not possibly have earned more than the net income its books showed. In the Appendix (pp. 56-60) we reproduce tables showing in detail how the board's method multiplies Chase's corporate net income seven-fold. We have summarized them above in footnote 8 (p. 22).

It is evident, we submit, that what this Court meant to accomplish in the *Norfolk & Western* case has not been attained and must be restated if this Court intends that California observe it. The question deemed substantial there is even more so here, where the distortion resulting from blind adherence to the formulary apportionment is seven-fold instead of two-fold as it was there.

B. In denying the petition for rehearing, the Court of Appeal made a statement which comes closer to referring

to the evidence of distortion which was before it than anything else it said. It said of this Court's *Norfolk & Western* decision (App. 13):

> "The case is far removed from the present one, wherein the operations of the corporations are unitary, and separate accounting is not permitted."

Since the court rejected the controlling effect of the evidence of distortion which had led the trial court to find that the formula did distort, and since no other explanation is offered, the foregoing statement may contain the explanation. If so, the explanation is erroneous and misconceives both *Norfolk & Western* and the nature of acceptable evidence to prove distortion. Since the refusal to consider evidence showing distortion produces an unconstitutional result, a substantial federal question is presented.

The Court of Appeal's statement is wrong in every relevant respect. First, *Norfolk & Western* involved a railroad operating an archetypical unitary business, and the Court of Appeal thought, erroneously, that the two businesses before it involved a single unitary business. Therefore that asserted distinction does not exist.

Second, under the Missouri statute separate accounting was not permitted, and a particular apportionment formula was mandatory. If, as the Court of Appeal appeared to say, the California statute also made use of an apportionment formula mandatory, then the two statutes were identical in substance and not distinguishable.

Third, no one in this case is asking for the use of separate accounting as a geographical allocation device. We used the standard three factor formula in our returns, not separate accounting. What Chase objects to is having the formula applied to the income of other corporations and having a tax so computed assessed to Chase.

But in the state courts, the California Attorney General consistently referred to the evidence in the case as "separate accounting". While we equally consistently corrected him, the Court of Appeal may have used the term in that sense. If it did, then it meant to hold that all evidence of distortion is separate accounting and objectionable. This was the actual effect of its decision, so it may have meant, by this veiled ambiguity, to describe what it actually did.

The evidence this Court found convincing in *Norfolk & Western* was separate accounting in the same sense. The Court of Appeal had this fact before it in our briefs.

Since there was no unfair dealing or other improper shifting of net income between the corporations, the court must have meant to hold that as a matter of law a subsidiary cannot accurately distinguish its net income from that of its parent.[15] This may be California law but it is factual nonsense. Where, as here, a subsidiary operates an integrated business and its only connection to its parent is buying its raw material from the parent at prevailing market prices, minor cost saving steps which are reflected in lower costs for both, and subordination to its parent's power on major policy matters, the separate net income of the subsidiary can be determined.

It is done by the accounting profession regularly for scores of subsidiaries which have to report to minority shareholders, and their statements are certified by the profession.[16]

It is required by the federal Securities and Exchange Commission as a condition to registration of the subsidiary's

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15. The California statute defines a subsidiary for this purpose as a corporation more than 50% of the stock of which is owned by another corporation. Rev. & Tax. Code § 25105.

16. Indeed, Chase's accountants certified its annual report for each year in issue. The text of the certification is in Appendix G (App. 49-51).

stock for trading.[17] Where the ownership by the parent is less than 80% and more than 50%,[18] certification by the independent accountants of the subsidiary's net earnings, assets and liabilities is required as a condition to registration of the parent's stock for trading. (SEC Regulations, 17 C.F.R. part 210.)

It is required by the federal Internal Revenue Code and regulations where consolidated returns are not filed. They cannot be where the parent owns less than 80% of the voting stock and need not be where it owns more.

With such common, frequent occasion to determine the corporate net incomes of subsidiary corporations for use by the public, stock exchanges and federal agencies, the techniques for doing so have been sharpened by practice and public and official scrutiny. To dismiss such a determination as non-evidentiary is arbitrary, and since such dismissal means that there cannot be credible evidence of a fact in issue under the Due Process and Commerce Clauses it also means that there is no way of vindicating a constitutional right.

Yet the position that all evidence of distortion is separate accounting was urged by the California Attorney General in the California courts. He was not deterred by his lack of success in the trial court. Like the Bellman who insisted that anything he said three times is true,[19] he said it again and again, and in the Court of Appeal it was accepted as true.

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17. Thus, Aerojet General Corporation is more than 80% owned by General Tire and Rubber Co. and its minority shares are listed and traded on the American Stock Exchange. Many Bell System subsidiaries, more than 80% owned by American Telephone, list their minority shares on the New York Stock Exchange, where they are actively traded; viz, Pacific Telephone and Mid-Continent Telephone.

18. A distinction California's statute does not make. Rev. & Tax. Code § 25105.

19. Carroll, The Hunting of the Snark, Fit. 1, The Landing.

But it is not true, and its acceptance as if it were has the effect of denying appellant and other California taxpayers their constitutional rights.

III. This case is a test case, testing California's asserted right to require combined income reporting of affiliated corporations regardless of the facts. A congressional committee which studied state taxing practices at length reported (H.R. Rep. No. 1480, 88th Cong., 2d Sess. at 245 (1964):

> "[T]he term "combined report" is used to describe a report in which the taxable corporation's net income is combined with the net income of a nontaxable out-of-State corporation. . . . The combined income is then apportioned to the taxing State. Of the two corporations, only the in-State corporation is technically liable for the tax.
>
> "Under the combined report concept, a number of problems can arise. First of all, the concept raises questions in respect to the power of a State to require that an out-of-State corporation's income must be included in the measure of a tax imposed on an in-State corporation. This may arise as a constitutional question or in terms of the limitations on State taxing power imposed by Public Law 86-272. In the latter case, the question is whether a State may require a company within its taxing jurisdiction to include in the measure of its tax income from an affiliate which is covered by an exemption in that statute. This question is unsettled, and as a result at least one State, California—the leading exponent of the combined report concept—anticipates that it will have to litigate the issues involved."

The litigation California anticipated is here, in this case. If California can succeed here, it may be assumed that other states may follow suit. So far, only in Oregon has a similar effort succeeded.[20]

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20. *Zale-Salem, Inc. v. State Tax Comm.*, 237 Ore. 261, 391 P. 2d 601 (1964).

Congress gives no indication of providing an early end to this dispute over constitutional power. No bill has become law since that 1964 report, and the one which passed the House, to die in the Senate, provided no tests for the propriety of combined reports. Nor does the Uniform Allocation of Income Act, now adopted in more than half the states, do so. Presumably the reason for all this legislative silence is that the problem is generally recognized as a constitutional one arising under both the Due Process and Commerce Clauses, on which this Court's views must be heard, since they may be dispositive.

Congress has, however, enacted one statute, which California's technique here would circumvent. This is Public Law 86-272 (15 U.S.C. §§ 381-384), adopted in 1959, before the tax assessment in issue here. It prevents California's taxing Kennecott, Kennecott Sales and Kennecott Wire directly, a jurisdiction California denies it is asserting here anyway. California seeks to circumvent lack of jurisdiction, whatever its source, by allocating the income of a corporation it cannot tax to a corporation it can tax, and taxing it there.

If California is successful here, Public Law 86-272 will be readily circumvented by that state and all others adopting the California technique where affiliated corporations are involved.[21]

The decision here will, accordingly, if permitted to stand, have national consequences in undermining the effect of Public Law 86-272, as well as in sanctioning the circumvention of heretofore well established constitutional limitations on jurisdiction to tax. Thus it presents a substantial federal question.

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21. Normally when Congress confers or limits jurisdiction over corporations, it does not mean to authorize disregard of the corporate entity except in instances where the corporations themselves have done so. *Cannon Mfg. v. Cudahy Packing Co.*, 267 U.S. 333.

IV. This is a corporate franchise tax, not an income tax, a distinction this Court has said is "one of substance, not of form" (*Pacific Co. v. Johnson,* 285 U.S. 480, 490). In so stating, this Court sustained California's right to include tax exempt interest in the measure of the tax, because that income contributed to the value of what was taxed and hence was a rational element in measuring its value.

The reality of the distinction between taxing net income directly and taxing the privilege of exercising a corporate franchise was underscored again in *Spector Motor Service, Inc. v. O'Connor,* 340 U.S. 602, where this Court struck down a tax on the privilege of doing interstate business, measured by net income. A direct tax on income, fairly apportioned, would have been permissible.

Kennecott's income is not a rational measure of the value of Chase's franchise. Chase does not own Kennecott, and is not enriched by Kennecott's income. The question whether, absent abuses not even suggested to be present here, Chase may be compelled to pay a tax to California for doing its business there, measured not by its own income but by its parent's, is a substantial and undecided one, involving Due Process and Commerce Clause questions.

The leading case, written by a judge who later became a distinguished member of this Court, is *Studebaker Co. v. Gilchrist,* 244 N.Y. 114, 155 N.E. 68 (1926). It held that a franchise tax on a subsidiary cannot be measured by its parent's income, unless the facts warrant the disregard of the corporate entity. California has never suggested that there are such facts here, and it even stipulated that Kennecott does not do business in California. (App. 2, 29.)

One could say with more conviction that the measure of value of a parent's franchise could include the subsidiary's income, since the parent owns the subsidiary and

the reverse is not true.[22] Even here, though, the state courts which have passed on the issue have usually refused to permit the consolidation of parent and subsidiary and the application of a combined formula to the total. *Square D Co. v. Board of Tax Appeals,* 415 S.W. 2d 594 (Ky. 1967); *Gulf Oil Corp. v. Clayton,* 267 N.C. 15, 147 S.E. 2d 522 (1966). Those courts have required evidence of abuse to justify the disregard of the corporate entity.[23]

California thus stands nearly alone among the states.[24] Its decision is the more remarkable because it is unnecessary to protect the state's valid interests. California has three statutory sections[25] modelled after section 482 of the federal Internal Revenue Code which allow it to shift income and deductions between affiliated corporations in instances of distorting or unfair dealing between them, and even to combine them in such instances. No argument was

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22. Thus in *National Leather Co. v. Massachusetts,* 277 U.S. 413, a franchise tax on a parent corporation which conducted all of its business in the taxing state, measured by assets employed including the stock in two subsidiaries which tanned leather for it in the same state, was sustained. The Court said that the facts showed that the parent employed the stock of the subsidiaries in its business. The reverse could not possibly have been true.

23. New Jersey did not, in *F. W. Woolworth Co. v. Director,* 45 N.J. 466, 213 A. 2d 1, deeming a finding of fact that unity was present sufficient to support a consolidation. The court emphasized the fact that it was a parent whose franchise was being valued. The court also emphasized (213 A. 2d at 8) that the case was not one of "distinct products, services and functions separately conducted . . . through subsidiaries." The court itself thus distinguished the case before it from one such as the instant case.

24. Prior to the decision below, the lone California decision was *Edison California Stores v. McColgan,* 30 Cal. 2d 472, 183 P.2d 16 (1947), where the facts stated by the state court justified the disregard of the corporate entity and the opinion, though ambiguous, could have meant to rest on that ground. It was not so construed below, nor in *Zale-Salem, Inc. v. State Tax Comm.,* 237 Ore. 261, 391 P. 2d 601 (1964), which sustained the taxing technique employed here.

25. Rev. & Tax Code §§ 25102, 25103 and 25104. App. 26-28.

made by the tax administrator or the Court of Appeal that this was such a case, and the code sections were not relied on. Instead the general allocation section, which one would have thought from its face[26] was intended to apply to business done by a single corporation, was relied on.

This Court has considered two cases where a state attempted to combine parent and subsidiary in a single franchise tax. In *Southern Ry. Co. v. Kentucky*, 274 U.S. 76, this Court held the attempt invalid. Kentucky assessed the parent, which had no trackage in the state but owned a subsidiary which did. The state sued the parent for a franchise tax, allowing a credit for the franchise tax paid by the subsidiary. This Court held the asserted tax invalid as an effort to reach extraterritorial property, because it found that the "operating results of the system, compared with those . . . in Kentucky show that" the Kentucky values were very much less than the system average. (274 U.S. at 83) The Court did not, accordingly, find it necessary to consider whether the parent could have been taxed had the asserted tax been properly apportioned.[27]

The second case is *National Leather Co. v. Massachusetts*, 277 U.S. 413, where the Massachusets franchise tax was asserted against the parent, which had its commercial domicile in the state, measured by property owned, including the capital stock of two subsidiaries. The Court chose to sustain the tax on the ground that the parent used the stock of the subsidiaries in its business. The subsidiaries tanned leather uppers in Massachusetts which the parent resold. Thus no question of extraterritorial taxation was presented beyond the claim that the mobilia doctrine placed the stock

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26. Rev. & Tax. Code § 25101, App. 25-26.

27. Mr. Justice Brandeis filed a lone dissent in which he indicated that he would have joined in the decision had he thought that the federal question was seasonably raised below.

of the subsidiaries outside Massachusetts because the parent was incorporated in Maine. The decision sheds no light here.

By contrast, this Court has held that a state does not acquire jurisdiction over the parent merely because it owns a subsidiary over which the state does have jurisdiction. *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, an opinion written by Mr. Justice Brandeis for the unanimous court which is almost contemporaneous with the *Southern Railway* case. The decision rested on the view that "the defendant, a foreign corporation, was not within the state" (267 U.S. at 336) for purposes of service of process, which was what was involved. Thus California could not sue Kennecott for a tax; instead it has assessed the tax against Kennecott's subsidiary.

Moreover, in *Hoeper v. Tax Commission*, 284 U.S. 206, this Court held that a state cannot tax a natural person on the income of another natural person. There are limitations to this doctrine, of course, but it has not been undercut as a general constitutional proposition. There are also limitations to its applicability to affiliated corporations, we know, but the question whether a state which elects to enjoy the advantages of a corporate franchise tax is limited to measuring the tax on that franchise by its values is vividly suggested by it.

As in *Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, here no case is made for a disregard of the corporate entity of either parent or subsidiary, as the state recognized when it stipulated that Kennecott did not do business in California. Having elected to observe the corporate entity by taxing its exercise, the state should be required to confine its tax to the value of what it taxes.

Under this Court's decisions, there is, accordingly, a federal question which is substantial and unresolved.

V. California's action herein raises substantial questions of discrimination against members of affiliated groups. The questions can be raised not only under the Equal Protection Clause but also under the Due Process Clause[28] and the Commerce Clause.

The discrimination lies in the fact that Chase's competitors, although they buy copper from Kennecott at the same price as Chase, do not have to pay a California tax measured by any of Kennecott's net income. Two independent fabricators, Revere Copper & Brass and General Cable, annually purchased a combined total of 87,000 tons of copper from Kennecott (App. 19), some of which was shipped to their California plants (App. 37). Asarco owned about one-third of their stock (App. 19), and Kennecott none. They would not be consolidated for California franchise tax purposes with each other, with Asarco or with Kennecott, since none of them owned more than 50% of the other.

The illustrations can be multiplied. The point is that a subsidiary finds it must pay more in taxes to California than an independent competitor.

This discrimination is unconstitutional. Multi-state operations involve interstate commerce of course. A burdensome classification between competitors merely because of stock ownership is an unreasonable burden on commerce, and a denial of due process unless the differences arising because of stock ownership justify that classification.

No significant advantages are shown to adhere to Chase because Kennecott owns its stock. This discrimination against it raises substantial federal questions.

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28. Discrimination violative of the equal protection clause can also violate the due process clause. *Bolling v. Sharp*, 347 U.S. 497; *Detroit Bank v. United States*, 317 U.S. 329; *Currin v. Wallace*, 306 U.S. 1; *Chas. C. Steward Mach. Co. v. Davis*, 301 U.S. 548.

CONCLUSION

Substantial federal questions are presented. Probable jurisdiction should be noted and a plenary hearing on the merits granted.

Respectfully submitted,

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Appendix A

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed—Apr 29 1970

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,

Plaintiff and Respondent,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Defendant and Appellant.

Franchise Tax Board of the State of California (herein, the Board) appeals from a portion of a judgment in the amount of $231,257.32 plus interest, which was awarded to plaintiff in this lawsuit to recover taxes paid under protest. The taxes are upon the franchise to do business in California during the years 1954, 1955 and 1956; but in order to make the reading easier, operations and relationships among companies are sometimes narrated, in this opinion, in the present tense.

Plaintiff, Chase Brass and Copper Co., Incorporated, is a wholly owned subsidiary of Kennecott Copper Corporation. The principal question is whether plaintiff's business is unitary or nonunitary with Kennecott, and a lesser question is whether plaintiff's business is unitary with any of Kennecott's other subsidiary corporations. If the business be unitary, a much larger franchise tax would be imposed than if the business be nonunitary. It is not always unfavorable as to tax for a corporation to conduct a unitary

business; for example, in the leading cases of *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, *and Honolulu Oil Corp. v. Franchise Tax Board,* 60 Cal.2d 417, the corporations asserted, successfully, that their California operations were unitary with those conducted outside the state.

In the case before us, plaintiff computed its California income, using an allocation formula which is applied to non-unitary enterprises and which takes into account sales, property and payroll within the state as compared with those existing outside. The Board disagrees with this method of computation; it has assessed taxes at a much higher figure on the "unitary business" theory.

The Corporations

The parent is Kennecott Copper Corporation (called Kennecott herein), the nation's largest producer of copper, a New York corporation. It does no business in California. It mines, smelts and refines copper, gold, silver and molybdenite. The metals are mined in Utah, Nevada, Arizona and New Mexico. Metals other than copper are sold in operations completely unrelated to plaintiff. Copper is not fabricated by Kennecott, but is sold through a subsidiary of Kennecott, Kennecott Sales Corporation.

Braden Copper Company, a Maine corporation, wholly owned by Kennecott, operates mines in Chile. Ordinarily, it sold copper to the government of Chile and to purchasers in the world market, but not buyers in the United States. In the years relevant hereto, however, because of shortages, it did sell, through Kennecott Sales Corporation, in this country. Plaintiff was a buyer. Braden does not fabricate; it sells fungible copper.

Bear Creek Mining Company, a Delaware corporation, owned by Kennecott, explored for metals in California in the relevant years, but made no significant discoveries. It

is the third company in the mining group consisting of Kennecott, Braden, Bear Creek.

The procedure beyond mining and refining of copper, sales, is committed to Kennecott Sales Corporation (herein, Kennecott Sales), a New York corporation, wholly owned by Kennecott, which in 1934 took over the sales and activity theretofore assigned by Kennecott and Braden to an independent agency. The sale of copper by Kennecott and by Braden within the United States is done by Kennecott Sales. No sales are made in California; Kennecott does no business here. Its sales of copper which enters this state are completed elsewhere. Kennecott Sales charges Kennecott a commission on the sales.

Kennecott Wire and Cable Co., (herein, Kennecott Wire), a Rhode Island corporation, owned by Kennecott, manufactures copper rod, wire and cable for transmission of electricity. It uses refined primary copper, all of which it buys from Kennecott or Braden through Kennecott Sales. Its sales operation in California is largely through plaintiff. Kennecott Wire did not do business in California in the relevant years.

Finally, there is plaintiff, Chase Brass and Copper Co., Incorporated, a Connecticut corporation, wholly owned by Kennecott. Like Kennecott Wire, it is a manufacturer. Its products are brass (made of copper and zinc), bronze (copper and alloys, mostly tin), and copper rod, sheet, wire and tube. The manufacture is done entirely outside California. Copper is bought from Kennecott Sales, derived from Kennecott and Braden, to the extent of 80 to 84 percent of Chase's needed supply. Within California, Chase warehouses and sells its products and those of Kennecott Wire.

The Franchise Tax Law

When a corporation engages in multistate business, including business in California, and the business is unitary,

there must be an allocation of income by formula. Separate accounting is not allowable, although it is usable for a corporation which, by operating here and elsewhere, conducts a nonunitary business. In the case of Chase itself, it was always recognized by the company that its own business is unitary, wherefore its own computation of the franchise tax was done according to formula. But the Board contends that the geographic unitary character of Chase is not all that is to be considered; there must also be taken into account the whole intercorporate parentage and affiliation of the Kennecott family. Mainly, it is the vertical aspect which is put before us: the relationship of Chase to Kennecott Sales, to Braden and to Kennecott. Secondarily, there is to be considered the horizontal relationship of Chase to Kennecott Wire.

Intercorporate unitary character of business, in which the activities of the parent are considered, under an appropriate factual situation, is a valid concept for taxing purposes. (*Edison California Stores v. McColgan,* 30 Cal.2d 472.) This holding of the *Edison Stores* case was but a logical sequence of the holding in *Butler Brothers v. McColgan,* 17 Cal.2d 664, in which a single company had operated through wholly controlled branches. In both cases, there were strong and embracing central controls. The general test which we are to apply is this: "If the operation of the portion of the business done within the state is dependent upon or conrtibutes to the operation of the business without the state, the operations are unitary." (*Edison California Stores v. McColgan, supra,* at p. 481; *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 412.) A more particular statement of the test is that a business is unitary if these circumstances are present: "(1) Unity of ownership; (2) Unity of operation as evidenced by central purchasing, advertising, accounting and management divisions;

and (3) unity of use of its centralized executive force and general system of operation." (*Butler Brothers v. McColgan, supra,* at p. 678; *Superior Oil Co. v. Franchise Tax Board, supra,* at p. 412.)

In applying these tests, we are considering a question of law only, because the facts, as placed before the trial court and before us, consist of a lengthy stipulation between the parties and some uncontradicted testimony. We must, therefore, make our own judgment on the question of law, and we cannot rest upon findings of fact made by the trial judge. (*Standard Register Co. v. Franchise Tax Board,* 259 Cal.App.2d 125, 129-130; *Household Finance Corp. v. Franchise Tax Board,* 230 Cal.App.2d 926, 930; *Montgomery Ward & Co. v. State Board of Equalization,* 272 A.C.A. 823, 828-829. See also *RKO Teleradio Pictures, Inc. v. Franchise Tax Board,* 246 Cal.App.2d 812, 816; *Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 413.)

Unity of Ownership

As is usual in disputes of this kind, ownership of one corporation by another is present. This means, of course, that the owner (its stockholders and directors) expects, or at least hopes, that its subsidiary will make a profit. But more is required for a business to be unitary, that is, fulfilment of the other two tests.

Unity of Operation

Although there is not a clear demarcation between what is "operation" and what is "use," in general it may be said that the acts falling within the category of "operation" are the staff functions, and those within "use" are the line functions.

The staff functions of a vertically integrated enterprise probably are not so markedly unitary as they are in a horizontally integrated business. This is so because, in the case of horizontal integration, functions such as central control of advertising of the same product, central purchasing, and the like are designed to give advantages to the business despite geographic differences. In the case of vertical integration involving various steps in the production and distribution, integration of staff functions probably will be considerably less. Nevertheless, when we consider each of the functions of Chase coming under the heading "Unity of Operation," in connection with those of its parent, Kennecott, we find considerable cooperation.

Purchasing: Under this heading, we consider the buying of items other than the purchase of copper, because copper buying is an essential "line" function. As to the auxiliary supplies, it is stipulated that Chase had its own purchasing department staffed by its own personnel. But Kennecott does some "minor" purchasing for Chase. In some instances, insurance was purchased for two or more companies in order to obtain a more favorable rate or better coverage or a better spread of risk. There was no intercompany coverage on basic industrial policies such as fire, fire use and occupancy, workmen's compensation, public liability, automobile liability and fire, sickness and accident, hospitalization and surgical, and certain types of bonds.

Advertising: Chase maintains its own advertising program and budget. The name and trademark of Chase are predominant in its advertisements, but these often contain a statement that Chase is a subsidiary of Kennecott. When Chase places advertising through an advertising agency, it uses the same agency that is used by Kennecott.

Accounting: Kennecott and Chase keep separate books of account, but the two use the same accounting firm.

Kennecott prepared consolidated tax accounts for Chase.

Legal: Chase has its own legal staff and on occasion employs its own outside counsel. Presentation of the protest of Chase before the Franchise Tax Board in these proceedings was handled by Kennecott employees.

Financing: In 1955, Chase's mill at Waterbury, Connecticut, was severely damaged by flood. Kennecott made loans to Chase, in the amount of $10,000,000, for rehabilitation of the plant. The prime bank rate of interest, which was then three and a half percent, was charged. The loan, including interest, was repaid within four years. We find this to be substantial evidence of unity of operation. It may be that Chase could have borrowed the money from lending institutions, but the fact remains that it could turn readily to its parent for help. It must have been deemed advantageous to the over-all management to have handled the transaction in this way, otherwise a separate arrangement would have been made.

Retirement Plan: There is a common retirement plan for salaried employees, which is administered by Kennecott, because when it was installed it appeared to be more economical and because it assures salaried employees in each company the same treatment as those in other Kennecott companies.

Unity of Use

Unity of use relates to executive forces and operational systems. (*Superior Oil Co. v. Franchise Tax Board,* 60 Cal.2d 406, 415.)

Executive Forces: The integration of executive forces is an element of exceeding importance. It is top level management which is credited (or, in case of failure or indifferent results, debited) with the effects of corporate enter-

prises. Chief executives of large organizations are regarded as highly prized acquisitions. They are induced to join a corporation, or to remain with it, and to exert their best efforts, not only by generous salaries, but also in many cases by incentive plans of various kinds. For a subsidiary corporation to have the assistance and direction of high executive authority of such a corporation as Kennecott is an invaluable resource. The stipulation of facts reads: "The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters." The "major policy matters" are what count in our estimation of integration. Day to day operations are made at various levels by many executives in any organization. They are made, no doubt, by a multitude of officials of Kennecott and its subsidiaries. Major policy is another thing. This was the concern of Kennecott.

Not only was there opportunity for control at the highest levels. The salaries of Chase's executives (and of those of Kennecott Wire) who earned more than $15,000 a year were subject to review by Kennecott. Exercising regulation of salaries of Chase's executives, even of those who were compensated at a not particularly sizable figure, Kennecott could control costs of management. Besides, these executives could hardly fail to recognize that their compensation

was dependent upon the decision of Kennecott's salary committee.

It is true that the president of Chase had a complete staff and line organization under his direction, but executive control at the highest level was in Kennecott.

Chase and Kennecott Wire: Inextricably bound to Chase's vertical relationship with Kennecott is its horizontal tie with Kennecott Wire. In fact, the relationships between Chase and Kennecott Wire, described in this paragraph, are evidence of the central control of these sibling corporations by their parent, Kennecott. Who would decide the extent of the horizontal relationships and whether the joint activities were mutually advantageous to the siblings, and commonly so to the parent, but the parent itself? Kennecott Wire, like Chase, is a manufacturer. Since 1944, Chase has taken over the sales of the major part of the products of Kennecott Wire. Chase warehouses the products of Kennecott Wire; Chase salesmen call on prospective wire and copper customers. If the salesmen obtain orders, they send them to Kennecott Wire. The orders are filled and shipped in the name of Chase. Chase receives a discount on the products sold. Chase does much of the accounting and reviews the taxes for Kennecott Wire. The former president and the general sales manager of Kennecott Wire had been Chase employees. Although the products, all of them composed to some extent of copper, are different, the activities clearly show a unitary business. (*RKO Teleradio Pictures, Inc. v. Franchise Tax Board,* 246 Cal.App.2d 812.) Respondent argues that unity of ownership is absent. In form this is correct, but in substance the unity of ownership is present because Kennecott is the sole owner of Chase and of Kennecott Wire.

Purchase of Copper: Kennecott sells about 20 percent of its total copper production to Chase through Kennecott

Sales. During the relevant years, there was an industry-wide copper shortage so that Kennecott would have had no difficulty in selling copper to others. This does not mean, however, that there was no contribution at all to Kennecott by Chase except the profits which Chase might make and which would redound to the benefit of Kennecott as sole stockholder. Although the three years, 1954, 1955 and 1956, are the only ones involved in the present case, these years are not the only ones in which the two corporations have been interested for their anticipated prosperity. Chase has been owned by Kennecott since 1929. To have a buyer of a substantial portion of the parent's production throughout the years must be assumed to be an advantage.

It is the position of respondent that Chase gained no particular advantage during the years in question by reason of the parentage of Kennecott. Kennecott sold to Chase at exactly the same price as that which it charged Chase's competitors. Moreover, during the period of shortage an allocation was made based on prior sales. Respondent does not contend that price equality was the result of benevolence toward other consumers, including competing companies. The equality was under compulsion of the Robinson-Patman Act (15 U.S.C. § 13a). But it is argued that under these conditions Chase is no more unitary with Kennecott than is, for example, another large buyer from Kennecott, Revere Copper & Brass Company. Here, again, however, we remark that the three years are not the only ones to be considered. The percentage which governed the amount of copper allocable to Chase was built over the years.

The fact of the sales alone, however, whether specially advantageous to Kennecott or to Chase, does not determine the business to be unitary. The factors described under headings above, and particularly those relating to control

of major policy, together with the subject of sales, bring us to the conclusion that the business among Kennecott, Kennecott Sales and Chase is unitary.

Except for the matter of sales and joint ownership, Braden and Chase are not unitary. We support the conclusion of the trial judge to this extent. As to Bear Creek, too, there is no such relationship as would allow formula computation of the taxes on the unitary theory. We agree with respondent on another point, namely, that Kennecott's sales of gold, silver and molybdenite metals, which are not bought by Chase or Kennecott Wire, are not part of the unitary business. The fact that these metals come from the same ore as that which produces copper is not sufficient to cause their sales to be included in the computations which are to follow.

The Board concedes that there is error in the property factor as it was applied, because of the decision in *McDonnell Douglas Corp. v. Franchise Tax Board*, 69 Cal.2d 506; wherefore, the case must be remanded in any event. Our decision requires further revisions of the formula.

We reverse the judgment, with directions to the trial court to proceed in accordance with this opinion.

Devine, P. J.

We concur:

Rattigan, J.

Christian, J.

Appendix B

In the Court of Appeal of the State of California
First Appellate District, Division Four

Filed—May 28 1970

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,

Plaintiff and Respondent,

vs.

FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,

Defendant and Appellant.

OPINION ON DENIAL OF PETITION FOR REHEARING

By the Court:

This is in response to requests by the parties for further rulings and explanation:

1. The formulary taxation procedure is not in itself a simultaneous process of taxing and of disregarding the separate entity of the taxed corporation. (*Edison California Stores v. McColgan*, 30 Cal.2d 472, 481.)

2. We do not regard the case of *Norfolk & Western Ry. Co. v. Missouri State Tax Comm.*, 390 U.S. 317, to be decisive or even relevant to the case at hand. In the *Norfolk* case, the railroad was able to show, by actual count of its rolling stock on the lien date, that the number of units within Missouri was substantially less than that which had been assumed by the taxing authorities, and that a certain "enhanced value" theory proposed by the taxing authorities would require a challenge to a total value figure which had

been agreed upon. The case is far removed from the present one, wherein the operations of the corporations are unitary and separate accounting is not permitted.

3. Since the formula must be recomputed, the special issues relating thereto, which our opinion has not resolved, are to be presented to and tried by the trial court (the subject of the gold, silver and molybdenum operations, however, has been decided by our opinion).

The petition for rehearing is denied.

Dated: May 27, 1970

Devine, P. J.

Appendix C

Filed Mar-1968

Superior Court of the State of California
For the City and County of San Francisco

No. 538595

Chase Brass & Copper Co., Incorporated,
Plaintiff,

vs.

Franchise Tax Board of the State of California,
Defendant.

FINDINGS OF FACTS AND CONCLUSIONS OF LAW

The above-named case came on regularly for trial on November 14, 1966. Plaintiff was represented by Kent, Brookes and Anderson, appearing through Valentine Brookes. Defendant was represented by Thomas C. Lynch, Attorney General of the State of California, appearing through Ernest P. Goodman, Assistant Attorney General, and John J. Klee, Jr., Deputy Attorney General. Having considered all the evidence and the briefs submitted by the parties, the Court now makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. The facts stated in the Stipulation of Facts on file herein are true and the Court hereby adopts said Stipulation as findings of this Court.

2. The testimony of the witnesses offered by plaintiff is uncontradicted and the Court finds that the facts stated by said witnesses are true. In that regard, the Court specifically finds that:

(a) The fair market value of Kennecott's mining properties (including the equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$585,346,677
January 1, 1955	577,317,053
January 1, 1956	568,978,394
January 1, 1957	560,180,039

The Fair market value of Braden's mining properties (including equipment and reduction facilities at the mine sites) was as follows on the dates indicated:

Date	Fair Market Value
January 1, 1954	$141,606,405
January 1, 1955	141,475,283
January 1, 1956	141,133,657
January 1, 1957	140,779,691

The value of the equipment and reduction facilities at the mine sites, if owned by someone who could not use them in conjunction with the mines, would be mere salvage value.

(b) On February 12, 1952, the Republic of Chile required Braden thereafter to sell all copper it mined in Chile to the Chilean Government under Law No. 10255. The Chilean government set the price at which it would buy the copper, and then resold it at a profit to itself of about eleven cents a pound. While Law No. 10255 was in effect, Braden sold its copper to the Chilean Central Bank for the price set by the Chilean Government at 24½ cents per pound. This price was the same as the one in effect for sales of domestically

produced copper in the United States under federal copper price-control regulations promulgated during the Korean War. But World copper prices prevailing outside the United States averaged about 35½ cents per pound, and this was the price which the Chilean Central Bank obtained for its sales of Braden copper on the world market, and for its exports of copper to the United States. Since Chilean Central Bank personnel lacked experience in the international copper market, the Bank appointed Kennecott Sales the selling agent for all Braden copper so sold. This law was in effect until May 31, 1955, when it was repealed by Law No. 11828.

(c) The Chilean Government's Copper Department effectively set minimum prices at which exports could be sold after March 28, 1956. This was done by the Copper Department's pressure on the major Chilean copper producers, Braden and Anaconda, to enter into unpublicized agreements to sell all Chilean copper at the highest price prevailing on any of the major metal markets. As a result, Braden copper was sold in the United States domestic market at the London Metal Exchange price. The purpose of the Chilean action was to maximize its tax revenues from the copper producers.

(d) The Copper Department of the Chilean Government issues an export license for every ton of copper exported from Chile. In this manner, the Chilean Government assures a supply of domestically mined copper for the Chilean industrial users of copper. Braden, therefore must supply local Chilean industry with any amount of copper that they ask for. In some years, Braden has delivered substantial quantities of copper to Chilean industry, while in other years, it has delivered relatively little; in the years here involved, it delivered to Chilean industry from 4% to 16% of its annual production.

(e) Because it is fire-refined copper and not electrolytically refined copper, Braden copper was not well suited to sale on the United States market except for use in brass and bronze. It was customarily sold in the world market and not in the United States. Kennecott copper being electrolytically refined was sold in the United States market. When United States demand exceeded domestic supply (such as in early 1956), Braden Copper was imported into the United States. If it was to be used for conductive purposes it required re-refining, so it was largely sold for alloying into brass and bronze.

(f) The price of copper in the European market generally fluctuates more than does the domestic "producers' price." In the early part of 1956 when copper was in great demand, the European price was 87 cents per pound, whereas the domestic "producers' price" remained at 36 cents per pound.

(g) Neither Kennecott nor Braden has ever had an internal sales organization to sell its copper production. Prior to 1934, each sold its copper through an independent agency which received $1.00 per net ton commission. In 1934 Kennecott Sales was formed and took over the function of selling agent for Kennecott and Braden. Kennecott Sales was compensated therefor on the same commission basis that the independent agency had been. During the years 1954, 1955 and 1956, Kennecott Sales received $1.00 per net ton commission for sales of Kennecott's copper.

When Chilean law required Braden to sell its copper to the Central Bank of Chile, Kennecott Sales was appointed the Central Banks' selling agent for export sales of this copper, and was paid ½% of the net sale proceeds as commission. From May 1955 through March 1956, Kennecott Sales received $1.00 per net ton commission on sales of Braden copper. After March 1956 the commission was $1.25

per net ton. No tax authority of the United States or Chile has ever questioned the reasonableness of the commissions paid to Kennecott Sales.

(h) In the years in question, Braden had net profit on molybenite and Kennecott had net profit on metals other than copper, principally gold, silver and molybdenite, in the following amounts:

	1954	1955	1956
Braden	$ 1,786,328.29	$ 2,633,771.88	$ 2,611,516.06
Kennecott	30,321,857.61	32,743,300.57	34,835,182.66
Total	$32,108,185.90	$35,377,072.45	$37,446,698.72

For purposes of this finding, "net profit" means gross sales price less direct expenses incurred after the particular metal has been separated from the copper. "Net profit" does not take into consideration any indirect expenses, such as overhead, or any direct expenses incurred in the mining, concentrating or smelting of the ore prior to the time the copper bearing material is separated from the material containing these other metals; for internal accounting purposes, Kennecott treats all such direct expenses and indirect expenses as costs of producing copper.

(i) During the years 1954, 1955 and 1956, Kennecott operated oil properties jointly with Continental Oil Company. The Franchise Tax Board did not include that joint venture within the group of corporations which it determined constituted a unitary business. During these years, the books and records of the joint venture showed a loss.

(j) Kennecott Sales sells the copper produced by Kennecott and Braden to a relatively few customers. None of these customers other than Chase or Kennecott Wire are related by stock ownership to Kennecott. It is customary for Kennecott Sales to supply from 25 to 70 percent of the

copper requirements of any large fabricator to which it regularly supplies copper. During the years 1954, 1955 and 1956, Kennecott supplied to two independent fabricators, Revere Copper & Brass and General Cable, a combined annual average of about 87,000 tons of copper. About one-third of the stock of each of these companies was then owned by American Smelting and Refining Company, a major custom smelter and copper refiner. Nevertheless, Kennecott Sales supplied about 50% of Revere's copper requirements and about 60 percent of General Cable's.

(k) Anaconda, Phelps Dodge and Kennecott are the three big copper producers. Phelps Dodge's fabricating divisions consume all or nearly all of Phelps Dodge's copper production. Anaconda asks its customers not to ship the copper Anaconda produces to independent fabricators, but to use the Anaconda fabricating facilities instead. Because of this, it is doubtful that Chase and Kennecott Wire could buy substantial amounts of copper at the producer's price from any United States source other than Kennecott Sales. The producer's price is the price charged by the primary producers of unwrought copper; primary producers are the companies such as Kennecott, Anaconda and Phelps Dodge that are integrated from the mining through refining stages of copper production. The customer smelter's price is the price charged by companies such as American Smelting and Refining Company that smelt and refine reclaimed copper and copper mined by others. In the years 1954, 1955 and 1956 the producers' price was, on the average, lower than the custom smelter's price. The custom smelter's price fluctuates more often and over a greater range than does the producer's price.

(l) Neither Kennecott nor Kennecott Sales has ever used its market position to help Chase or Kennecott Wire acquire

a customer, although the opportunity to do so has existed. In times of copper shortages, Kennecott does not supply its subsidiaries copper more favorably than it supplies its other customers. Kennecott policy is one of not favoring Chase or Kennecott Wire in any way over any of its customers.

(m) The apportionment formula used by defendant operates to assign to Chase income earned by the income-earning activities of Kennecott, Braden and Kennecott Sales. Since the income-earning activities of all the corporations are separate and distinct and capable of ascertainment by reference to the operation of market forces, there is no need to resort to an artificial redetermination by formula of the incomes of each corporation.

(n) Chase's business activities are not so inter-related with the business activities of the other corporations as to make possible the earning of income by Chase or any of the others which is not properly reflected on each's separate books of accounts. Chase's income and expenses all arise as a result of arm's length dealing at market prices. The contacts between Chase and the other corporations were of extremely minor significance in relation to the income-earning activity of each corporation. The only substantial business contact between Chase and Kennecott was Chase's purchase of unwrought copper from Kennecott. This sole substantial contact was governed in all particulars by the operations of an independent marketplace.

(o) Kennecott does not need to own Chase in order to sell its copper. Since all copper sales from Kennecott to Chase are at arm's length prices and since Chase is treated by Kennecott as Kennecott treats any of its other customers, Kennecott's ownership of Chase permitted neither Kennecott nor Chase to earn more than either might have in the absence of that ownership.

3. In computing the assessed tax, defendant included in the numerator of Chase's property factor property in transit to California destinations in the following average amounts:

1954	1955	1956
$180,414.00	$296,282.00	$322,496.00

By stipulation, plaintiff and defendant agreed not to litigate the propriety of this adjustment. The parties agreed that one-half of the above sums for each year would be included in the numerator of Chase's property factor.

CONCLUSIONS OF LAW

From the foregoing findings of fact, the Court reaches the following conclusions of law:

1. Chase was not engaged in a unitary business with Kennecott, Braden, Kennecott Wire, Kennecott Sales or Bear Creek, collectively, or with any one or more of them. Accordingly, it was improper for the Franchise Tax Board to compute the California income of Chase and Bear Creek by the combined report approach. It was also improper for the Franchise Tax Board to assess Bear Creek's asserted tax liability to Chase.

2. In view of the foregoing conclusion of law that Chase was not engaged in a unitary business with any other corporation, this Court deems it unnecessary to determine any of the following issues presented by plaintiff:

(a) Whether defendant's particular apportionment formula was a proper one for consolidating the group's property, payroll, sales and net income.

(b) Whether defendant's assessment violated the equal protection clause of the Fourteenth Amendment to the United States Constitution.

(c) Whether defendant's assessment violated the interstate commerce clause of the United States Constitution (Art.I, § 8, cl. 3).

(d) Whether defendant's assessment violated the foreign commerce clause of the United States Constitution (Art. I, § 8, cl. 3, and the exclusive interest of the national government that its relations with Chile embodied in treaties and informal agreements be free from interference by California.

(e) Whether defendant's assessment violated pre-emptive federal legislation establishing the taxable status of Western Hemisphere Trade Corporations (Int. Rev. Code of 1954 §§ 33, 901-905, 921-922).

3. The Franchise Tax Board did not act unreasonably or arbitrarily in excluding from the property factor Chase's investment in the construction in progress at its Waterbury, Connecticut plant.

4. Plaintiff is entitled to judgment in the sum of $231,257.32, together with interest thereon from July 12, 1963, as provided by law.

Let judgment be entered accordingly.

Dated: March 6, 1968.

/s/ EDWARD MOLKENBUHR

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Judge of the Superior Court

Appendix D

In the Court of Appeal of the State of California
First Appellate District, Division Four

1 Civil 25911

CHASE BRASS AND COPPER CO., INCORPORATED,
Plaintiff and Respondent,
vs.
FRANCHISE TAX BOARD OF THE STATE OF CALIFORNIA,
Defendant and Appellant.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Chase Brass and Copper Co., Incorporated, the Plaintiff and Respondent above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeal of the State of California holding that the business of Chase Brass and Copper Co., Incorporated, is unitary with that of its parent, Kennecott Copper Corporation, and with that of Kennecott Sales Corporation and Kennecott Wire and Cable Co., entered in this action on April 29, 1970 (Petition for Rehearing denied by the Court of Appeal on May 27, 1970; Petition for Hearing denied by the Supreme Court of California on June 24, 1970), reversing to that extent the judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: July 10, 1970.

/s/ VALENTINE BROOKES

Valentine Brookes

Counsel for Petitioner and Respondent

I hereby certify that on this 10th day of July, 1970, three copies of the Notice of Appeal to the Supreme Court of the United States were mailed, postage prepaid to:

Thomas C. Lynch, Attorney General
John J. Klee, Deputy Attorney General
State of California
350 McAllister Street
San Francisco, California 94102,

counsel for Respondent and Appellant. I further certify that all parties required to be served have been served.

/s/ VALENTINE BROOKES
Valentine Brookes

1600 International Building
601 California Street
San Francisco, California 94108

Counsel for Petitioner and Respondent

Appendix E

CONSTITUTIONAL PROVISIONS

The Commerce Clause (Art. I, § 8, cl. 3):

"The Congress shall have Power . . . to regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes;"

The Due Process Clause (Amend. XIV, § 1):

"[N]or shall any State deprive any person of life, liberty, or property, without due process of law;"

STATUTES

California Revenue and Taxation Code:

25101. Basis of allocation. When the income of a taxpayer subject to the tax imposed under this part is derived from or attributable to sources both within and without the State, the tax shall be measured by the net income derived from or attributable to sources within this State. Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, pay roll, value and situs of tangible property or by reference to any of these or other factors or by such other method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such a manner as is fairly calculated to apportion such income among the states or countries in which such business is conducted. Income attributable to isolated or occasional transactions in states or countries in which the taxpayer is not doing business shall be allocated to the state in which the taxpayer has its principal place of business or commercial domicile.

If the Franchise Tax Board reallocates net income upon its examination of any return, it shall, upon the written request of the taxpayer, disclose to him the basis upon which its reallocation has been made.

(Added by Stats. 1955, p. 1644, in effect June 6, 1955. Adopted without change from former Section 24301.)

25102. Taxpayer owned or controlled by the same interests. In the case of two or more persons, as defined in Section 19 of this code, owned or controlled directly or indirectly by the same interests, the Franchise Tax Board may permit or require the filing of a combined report and such other information as it deems necessary and is authorized to impose the tax due under this part as though the combined entire net income was that of one taxpayer, or to distribute, apportion, or allocate the gross income or deductions between or among such taxpayers, if it determines that such consolidation, distribution, apportionment, or allocation is necessary in order to reflect the proper income of any such taxpayers.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303.)

25103. Corporation benefiting its members or stockholders by transactions at less than fair price. In the case of a corporation doing business within the meaning of this part, whether under agreement or otherwise, in such manner as either directly or indirectly to benefit the members or stockholders of the corporation, or any of them, or any person or persons, directly or indirectly interested in such business, by rendering services of any nature whatsoever, or acquiring or disposing of its products or the goods or commodities in which it deals, at less than a fair price therefore, the Franchise Tax Board, in order to prevent evasion of taxes or clearly to reflect the income of such corporation, may require a report of such facts as it deems

necessary, and may determine the amount which shall be deemed to be the entire net income allocable to this State of the business of such corporation for the calendar or fiscal year, and compute the tax upon such net income. In determining the entire net income the Franchise Tax Board shall have regard to the fair profits which, but for any agreement, arrangement, or understanding, might be or could have been obtained from dealing in such products, goods or commodities.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303a.)

25104. Consolidated report of parent and subsidiary corporations. In the case of a corporation liable to report under this part owning or controlling, either directly or indirectly, another corporation, or other corporations, and in the case of a corporation liable to report under this part and owned or controlled, either directly or indirectly, by another corporation, the Franchise Tax Board may require a consolidated report showing the combined net income or such other facts as it deems necessary. The Franchise Tax Board is authorized and empowered, in such manner as it may determine, to assess the tax against either of the corporations whose net income is involved in the report upon the basis of the combined entire net income and such other information as it may posses, or it may adjust the tax in such other manner as it shall determine to be equitable if it determines it to be necessary in order to prevent evasion of taxes or to clearly reflect the net income earned by said corporation or corporations from business done in this State.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303b.)

25105. Ownership or control. Direct or indirect ownership or control of more than 50 percent of the voting stock of the taxpayer shall constitute ownership or control for the purposes of this article.

(Added by Stats. 1955, p. 1650, in effect June 6, 1955. Adopted without change from former Section 24303c.)

Appendix F

Selected Portions of the Stipulation of Facts

IT IS HEREBY STIPULATED by and between the parties hereto by their respective counsel that for the purpose of trial of the above entitled case the facts hereinafter stipulated are true and correct and may be treated by this court as facts proven in open court.

• • •

2. The statements set forth below are applicable to the calendar years 1954, 1955, and 1956, unless otherwise specifically indicated.

3. (a) Kennecott is a corporation of the State of New York, with its main office in the City of New York. It is qualified to do and does business in many states of the United States, but it was neither qualified to nor did it do business in the State of California during the years in question. Kennecott is a publicly held corporation, its stock being listed on all major exchanges.

(b) Chase is a Connecticut corporation organized under the laws of the State of Connecticut in the year 1909, with its principal office and place of business in Waterbury, Connecticut. It has manufacturing establishments located in the State of Connecticut and in the State of Ohio. It is qualified to do business and is doing business in more than twenty-five states of the United States, including California. Ownership of all the capital stock of Chase was purchased by Kennecott from outsiders in the year 1929, and since then all of its capital stock has been wholly owned by Kennecott.

(c) Kennecott Wire, during the period in question, was a corporation of the State of Rhode Island. All its outstanding capital stock was purchased from outsiders by

Kennecott in 1935 and has been owned by Kennecott at all times since; after that stock acquisition, its name was changed from American Electrical Works to its present name.

(d) Bear Creek is a corporation of the State of Delaware. Bear Creek has done business in California and many other states. It qualified to do business in California on October 16, 1945. It formally withdrew from California on May 27, 1960, but again qualified on May 21, 1962, and continues to do business in California. Its stock is wholly owned by Kennecott.

(e) Kennecott Sales is a corporation of the State of New York. It is not qualified to do business in California. The stock of Kennecott Sales is wholly owned by Kennecott.

(f) Braden is a corporation incorporated in the State of Maine. It does no business in the United States and has neither assets (except bank accounts and securities) nor employees in this country. Braden is a wholly owned subsidiary of Kennecott. For federal income tax purposes, Braden qualifies as a Western Hemisphere Trade Corporation and files its federal tax returns on that basis.

4. (a) The principal business activity of Kennecott was and is the production of copper and other metals present in copper-bearing ore. This involves the mining, beneficiation, smelting and electrolytic and fire refining of copper-bearing ores and the selling of the metals and metallic compounds produced from the ores. Kennecott produced the following percentages of United States production of principal metals it produced:

	Gold	Silver	Molybdenum	Copper
1954	20.722	7.476	24.347	25.838
1955	21.919	10.410	26.500	25.247
1956	21.942	8.351	28.593	25.456

Kennecott was the largest copper producer, the second largest gold producer, the fourth largest silver producer and the second largest molybdenite producer in the United States in these years. Kennecott does not engage in manufacturing or fabrication in any way, other than such fabrication or manufacturing as it may do in its own shops for use in its various divisions, but this fabrication or manufacturing is not of products for sale.

Kennecott owns and operates as its western divisions, four mining properties in the United States, one being located in each of the States of Utah, Nevada, Arizona, and New Mexico. The products of Kennecott's four western divisions consist primarily of copper, gold, silver, molybdenite, and minor amounts of other metals, including selenium, platinum and palladium.

The copper as sold by Kennecott is in the usual commercial forms, such as slabs, cakes, ingots, ingot bars, cathodes, billets, and wire bars and copper precipitates. As such, the copper is fungible and is not in the form of commercial end use products.

Some of the copper is sold as blister copper, in which form it is used in the preparation of fungicides and chemicals, and in some cases it is further refined by the purchaser. Precipitate copper, which is obtained by leaching the waste piles, is sold in minor quantities for making pigments and for metallic power purposes, and the balance is not sold as precipitate but is fed into the smelter with other copper concentrates.

Some of Kennecott's copper (produced only at the Chino, New Mexico, Mines Division), is sold as fire-refined copper and is used primarily for non-electrical purposes and for producing certain types of brass and bronze but is not customarily further refined.

The balance of the copper, which is the major portion, is sold after being electrolytically refined and made usable for fabrication into brass mill or into wire mill products.

(b) Chase is primarily engaged in the manufacture and sale of brass, copper rod, sheet, wire, and tube, such products usually being designated in the trade as "brass mill products." Chase owns no mines, and does no mining, concentrating, smelting or refining of metals or ores. Chase is not engaged in the business of buying and selling virgin copper. The copper received by it, with minor exceptions, is changed in form by fabrication or by melting and then fabricating or by melting and combining with other metals to form alloys and then fabricating. Chase's sales are almost wholly domestic. In a typical year it will sell products to more than 18,000 accounts.

(c) Kennecott Wire's principal business during the years under consideration was the fabrication and sale of copper rod, wire and cable for electrical transmission purposes, such items being commonly designated and referred to as "wire mill products." In addition, it fabricated some nonferrous wire for the screencloth business, and also some aluminum wire and cable. Kennecott Wire owns no mines, and does no mining, concentrating, smelting or refining of metals or ores.

(d) The sole business activity of Bear Creek was the performance of mineral exploration and development services for Kennecott on a fee basis. The services it performed for Kennecott in California have never resulted in discoveries. It performed such services in the taxable years.

(e) The sole business activity of Kennecott Sales is the sale of all the metals produced by Kennecott and Braden to customers in the United States and abroad, except (a) gold and silver, which are sold directly by Kennecott; and

except (b) certain copper produced by Braden and sold for use in Chile under governmental regulation. • • •

(f) Braden owns and operates copper mines and milling, smelting, and fire refining equipment in Chile, which it owns in the Chilean equivalent of fee simple.

5. (a) In the years involved Kennecott was managed by a Board of Directors consisting of fifteen members, one of whom was an officer of Kennecott, except that in a portion of 1954 two directors were officers of Kennecott. None of the directors were residents of California. The Board of Directors of Kennecott did not handle the day to day operations of Kennecott's various divisions or subsdiaries. Rather, day to day operations of Kennecott were the concern of its executives and were handled by the general managers of the divisions. The day to day operations of the subsidiaries were the concern of the executives of the subsidiaries and were handled by various subordinate employees of the subsidiaries. The Board of Directors of Kennecott was primarily interested in, and devoted the majority of its time to, the larger problems facing the copper industry in general, including the development and maintenance of its fabricating subsidiaries. The President of Kennecott was concerned with basic problems and policies of the subsidiaries. The executives of the subsidiaries reported to the President of Kennecott with respect to major policy matters.

(b) The Board of Directors of Chase consisted of eight members. They are elected by Kennecott as the sole stockholder of Chase. Save for three officers of Kennecott, the directors of Chase, during the period in question, were all officers of Chase and residents of Connecticut. However, none of the three Kennecott officers attended a meeting of the Chase Board during the period in question. No em-

ployee or officer of Kennecott was an officer of Chase during the period in question or since.

During the three years in question, the President of Chase was Richard C. Diehl, whose office was at the main office of Chase in Waterbury, Connecticut, and from which office he directed the affairs of Chase. His time and attention were given to Chase; he was not responsible for the business operations of Kennecott or any of Kennecott's other subsidiaries. He had a complete staff and line organization under his direction which carried out the fabricating, pricing, selling, warehousing, purchasing, record keeping, advertising, employee relations, and all the other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

(c) The members of Kennecott Wire's Board of Directors were elected by Kennecott as sole stockholder. The Board consisted of either eight or nine members, of which at times five and at times four were officers of Kennecott. The quorum of the Board was three. No meeting was held in 1954, 1955 or 1956 at which an officer of Kennecott was present except for one emergency meeting held on December 28, 1955, when the President had suffered a cerebral hemorrhage and no quorum was available without Kennecott officers; the only business transacted at the meeting was a change in signatures on a bank account so that funds could be withdrawn during the President's incapacity. No employee or officer of Kennecott was an officer of Kennecott Wire during the period in question, or has been since. During the period in question, the President of Kennecott Wire was Alan F. Sheldon, whose office was at the headquarters of Kennecott Wire in Phillipsdale, Rhode Island. His time and attention were given to Kennecott Wire and he was not responsible for the business operations of

Kennecott or any of Kennecott's other subsidiaries. He also had a complete staff and line organization, which, under his direction, carried out the fabricating, pricing, selling (except such as was done by Chase under the arrangement described in paragraph 7) purchasing, record keeping, employee relations, and all other customary and necessary facets of a modern corporation engaged in fabricating and selling on a wide scale.

(d) Braden and Kennecott had common directors and officers. Charles R. Cox, the President of Kennecott and Braden, was the only Kennecott director common to Braden and Chase, to Braden and Kennecott Wire, and to Chase and Kennecott Wire.

6. The manner in which Chase conducted its business in the State of California has not changed substantially in all of the years that it has been qualified to do business in the State except for the sale of Kennecott Wire Products referred to in Paragraph 7. It did not act as an agent or representative of Kennecott or sell or otherwise dispose of any property owned by Kennecott. In general, its business dealings with Kennecott were confined to the purchase from Kennecott of virgin copper and the sale to Kennecott of relatively small amounts of merchandise as produced by it. Its purchases from Kennecott are effected from its main office in Waterbury, Connecticut. All of Chase's shipments into the State of California are in the form of products manufactured from copper or other metals or combinations thereof.

7. Until July 1, 1944, Kennecott Wire sold its products either directly through its representatives located in states in the Middle West or the Northeast or, in some cases, through distributors. By 1944 it had become apparent that Kennecott Wire could not continue operations as in the

past, because better outlets and warehouse stocks of certain of its products were needed at convenient locations. As a result of studies which were made as to what should best be done, on July 1, 1944, Kennecott Wire entered into an agreement with Chase whereby Chase took over the sales, through its various sales offices and warehouses throughout the United States, of the major part of the products of Kennecott Wire. Certain high volume accounts which could be supplied by carload lot shipments from the factory in the Northeast, were retained by Kennecott Wire and sold directly. Under this arrangement, Chase purchased stocks of products from Kennecott Wire, placed them in various of its warehouses, and then resold them in the areas covered by such warehouses. Additionally, Chase salesmen called on prospective wire and cable customers whether or not there was stock in the warehouses to which such salesmen were assigned to secure orders for products of types produced by Kennecott Wire. These orders were then transmitted to Kennecott Wire at its home office, the stock was produced by Kennecott Wire and billed and shipped in the name of Chase, with Chase receiving a discount on the products sold. Further, certain of Kennecott Wire's employees did promote sales of the products it produced, either alone or in conjunction with Chase's sales activities.

Prior to the Kennecott Wire—Chase agreement, Kennecott Wire did not have extensive warehousing facilities. After the agreement, it did not maintain any stocks of wire and cable in the Chase warehouses. When there was a stock of wire or cable in the Chase warehouses, it was the property of Chase, not Kennecott Wire. Under the

arrangement described above Chase did sell in the years in question Kennecott Wire products to customers in California.

8. Kennecott has no employees in California. Kennecott employees did not supervise Chase employees in California or elsewhere.

9. In the years in question, 1954, 1955 and 1956, no representative of Kennecott Sales was in the State of California for the purpose of selling, attempting to sell, or soliciting sales of metals for which it is the agent, nor for the purpose of missionary work of any type, nor was any representative of Kennecott in California for such purpose or purposes. The shipments into California were the result of negotiations outside California.

10. During the period in question, Kennecott shipped 14,032 tons of copper into California. Nearly all of this amount was bought by General Cable, American Smelting and Refining Company, and Revere Copper & Brass Company on orders negotiated with Kennecott Sales and placed by those companies through their New York offices. None of these corporations is owned or controlled by or affiliated with Kennecott or any corporation owned or controlled by it. There was no solicitation or direct dealing with the branches of these companies in the State of California. Twelve thousand tons of Braden copper were shipped to the General Services Administration of the United States Government on a contract made in Washington, D.C. for stockpiling in California.

In 1956 Kennecott also sold to the Mountain Copper Company Limited at Martinez in California twelve drums of copper precipitate totaling 3,035 pounds for what was understood to be an experimental order, and 30 tons of copper to the Chicago plant of H. Kramer & Company of

El Segundo, California. The only other shipments into the State of California in the years in question were of selenium, sold to the International Rectifier Company at El Segundo, California, and to Owens-Illinois Glass Company at Los Angeles and Oakland, California. In 1954, Kennecott sold International 3,350 pounds of selenium for $24,300; in 1955, 5,000 pounds for $59,400; and in 1956, 6,050 pounds for $105,400. On orders received from the main office of Owens-Illinois at Toledo, Ohio, Kennecott shipped to that company's plants in California 2,350 pounds of selenium in 1954 and 700 pounds in 1955. These sales were not solicited or obtained by Kennecott in California. None of the purchasing corporations is owned or controlled by or affiliated with Kennecott or by any corporation owned or controlled by or affiliated with it.

11. (a) The property of Chase in the State of California included inventories of the products which it was engaged in selling, located in warehouses either owned or leased by it in the City of South San Francisco and in the City of Los Angeles. The balance of Chase's California property consisted of real estate, office furniture, fixtures, machinery and equipment. It maintained a sales office at the warehouses in South San Francisco and in Los Angeles. It had no more than fifty-one employees either living in the State of California or representing it in the State of California.

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Throughout the United States, Chase had 7,617 employees on December 31, 1954, 8,197 employees on December 31, 1955 and 6,731 employees on December 31, 1956. In California it had 44 employees on December 31, 1954, 43 employees on December 31, 1955, and 50 employees on December 31, 1956.

(b) Of Chase's total sales in the years in question approximately 3.8% in 1954, 4.5% in 1955 and 4.9% in 1956 were to customers in California. Of Chase's sales of wire mill products, approximately 4.1% in 1954, 2.5% in 1955 and 4.5% in 1956 were to customers in California.

The amount of Chase's sales to California customers during the years here involved were:

1954	1955	1956
$6,506,833.00	$9,589,614.00	$10,422,917.00

12. (a) The amount of virgin copper purchased by Chase and Kennecott Wire from Kennecott is determined by the needs of Chase and Kennecott Wire; the amount of copper to be required for operations for a given month is estimated by Chase and Kennecott Wire, and Chase, which buys scrap, then subtracts from this amount the tonnage of copper content of scrap to be purchased from its own customers or from other sources such as scrap dealers. The balance usually represents the amount purchased from Kennecott.

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14. Kennecott, through Kennecott Sales, sells to Chase approximately 20% of its total production of copper and sells to Kennecott Wire approximately 4%, leaving about 76% which it sells to its other customers.

15. Those products produced by Chase and Kennecott Wire which were purchased by Kennecott were purchased at the going price which was the same price as was charged any other customer. The amount of sales by Chase and Kennecott Wire to Kennecott and its affiliates (exclusive of the sales by Kennecott Wire to Chase which were made for resale as described in paragraph 7) for the years here involved were:

1954	1955	1956
$329,982.00	$301,285.00	$451,039.00

16. In order that Kennecott and its subsidiaries might operate at the lowest possible cost, and in some instances, to assure results compatible to all the companies in which Kennecott owned stock, certain matters were handled either jointly or on a uniform basis, and they were as follows:

(i) Salaries of more than $15,000 for employees of Chase and of Kennecott Wire were submitted to Kennecott's Salary Committee.

(ii) There was some purchasing of supplies on contracts negotiated by Kennecott, but this was minor. Ordinarily, Chase and Kennecott Wire purchased from outside sources of each's own selection.

(iii) There were minor charges between the companies, but these charges were in no case greater than would have been charged by or to a company not affiliated with Kennecott.

(iv) There were some instances in which insurance coverage could be combined for two or more companies, with a more advantageous rate, or better coverage, or a better spread of risk. In one instance the cost of separate coverage would have been prohibitive. The charges in every case were prorated on an allocable basis. Kennecott could have secured the coverage desired without covering the subsidiaries. There was no intercompany coverage on basic industrial policies such as Fire, Fire U. & O., Workmen's Compensation, Public Liability, Automobile Liability and Fire, Sickness and Accident, Hospitalization and Surgical and certain types of bonds.

(v) There was a common Retirement Plan for Salaried Employees, which was administered on an overall basis by Kennecott in New York. The reason for having one

Retirement Plan is that, at the time it was installed, it appeared more economical. It also assured salaried employees in each company the same treatment as those in the other companies.

The Pension Plans for Hourly Employees, which covered hourly employees, were not only not uniform but also they did not cross the border between corporations, i.e., no Kennecott hourly employee was covered by a Chase or Kennecott Wire Plan, nor, conversely, were the employees of Chase or Kenecott Wire covered by the Kennecott Plans, nor did Chase and Kennecott Wire Plans cover employees of the other. Each corporation had a separate Plan or Plans, and each bore its own cost of administration.

17. There has been some interchange of employees between the various corporations identified in paragraph 1, but very little interchange between Kennecott and the fabricating companies, Chase and Kennecott Wire; not more than six salaried employees have been transferred to or from the fabricating companies and Kennecott in the last twenty years.

There have been no more than sixteen instances of transfer between Braden and Kennecott in the last fifteen years.

Employees have moved from the employment of Chase to Kennecott Wire and from Kennecott Wire to Chase. The former President of Kennecott Wire came from Chase, as did the General Sales Manager and an engineer. Officers and employees have also come from outside employment; viz., Charles Cox, president of Kennecott, from U.S. Steel Corp., Richard Diehl, president of Chase, from Wheeling Steel Corp., and Glenn Bakken, executive vice president of Chase, from Reynolds Metals Corp. When Chase entered

into the arrangement to sell most of the products of Kennecott Wire, it employed some salesmen and sales engineers previously employed by Kennecott Wire.

If there were hourly employees who transferred from one company to another, the transfers were made on their own account and not on company request.

18. Chase received loans from Kennecott totaling $10,000,000.00 to rehabilitate the Waterbury mill plant which was severely damaged in the flood disaster of 1955. On these loans, Chase was charged interest at the rate of 3½ per cent, which was equal to the prime bank rate of interest. All funds borrowed plus interest were repaid within four years.

19.(a) Chase handled its own personnel policy and industrial relations and did its own negotiating in labor matters. The labor advisor for Kennecott sometimes exchanged information with Chase relative to preparation of union contracts and rates of pay for various skills.

(b) Chase maintained its own administrative offices and kept its own separate books of account. It had its own accounting and internal audit staff, and handled its own tax matters with the exceptions noted below. In addition to its own manufacturing operations it had its own credit, purchasing and traffic departments, its own sales force, and its own research department and laboratory. These were staffed with its own personnel. Kennecott Wire prepared and sent Chase invoices to Chase customers for many sales by Chase of Kennecott Wire's products. Kennecott and Chase both made contributions to the Copper and Brass Research Association.

(c) Chase maintained its own internal advertising department and staff which worked independently in the

preparation and publication of material which advertised Chase products. Chase developed its own advertising program and budget, which was not submitted to Kennecott for advance approval. When Chase placed advertising through an advertising agency, it used the same agency that Kennecott used. The name and trademark of Chase is predominant in its advertisements in trade journals, magazines and newspapers. These advertisements often contain as part of the Chase trademark the statement that Chase is a subsidiary of Kennecott Copper. Kennecott's advertising often stressed the importance of "adequate wiring."

(d) In addition to its own manufacturing operations Kennecott Wire had its own personnel, purchasing, traffic and research departments which were staffed with its own personnel.

(e) In Chile, in addition to its own mining, milling, smelting and refining operations, Braden maintained its own administrative offices and its own purchasing, traffic, research, personnel and accounting departments which were staffed with its own personnel.

(f) Kennecott and all the subsidiaries used the same public accounting firm. Consolidated accounting and the preparation of certain tax reports were done by Kennecott in New York. During the years in question, Chase did the accounting and reviewed the taxes for Kennecott Wire for a fee. Kennecott furnished Braden whatever accounting, administrative and legal services Braden had a need for in the United States, and for this service Kennecott charged Braden a fee. Kennecott furnished Bear Creek and Kennecott Sales accounting, administrative and legal services for a fee.

(g) Chase had its own legal staff and on occasion employed its own outside counsel. Kennecott furnished Kennecott Wire with legal services for a fee. Kennecott employees handled the preparation and presentation of the protests of Chase and Bear Creek before the Franchise Tax Board in these proceedings.

20. On occasion, there have been loans of specialized personnel from Chase to Kennecott and from Kennecott to Chase, but these occasions have been infrequent. Also, Kennecott had two employees working at Chase for a period of approximately two years on a joint research program exploring the question of the compacting of titanium powder, a product of Quebec Iron & Titanium Corp.

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21.(i) Kennecott sold its copper to all its customers, including Chase and Kennecott Wire, at what is called the "producers price." Kennecott did not charge Chase or Kennecott Wire prices for copper that differed from prices it charged its other customers. The "producers price" is the price, published in trade journals, which is charged for domestic copper by the three giants of the copper industry: Kennecott, Anaconda, and Phelps Dodge. During periods when the copper fabricators are demanding more copper than is being produced by Kennecott, Kennecott would sell to its customers, including Chase and Kennecott Wire, on an allocation basis. The allocation procedure, which was normally based on amount of purchases during a particular test period, was determined by the management of Kennecott and Kennecott Sales, and was not used to give Kennecott subsidiaries special purchasing preference over Kennecott's other customers.

Kennecott and Braden deliver substantial amounts of metal annually to a relatively small number of customers.

The following schedules analyze total deliveries to customers for the years 1954, 1955 and 1956:

KENNECOTT COPPER CORPORATION

	1954	1955	1956
Total deliveries (U.S. and foreign) (in tons)	353,513	371,414	364,539
Total number of customers	83	64	70
Deliveries to the 25 principal customers (in tons)	315,572	344,770	343,178
Per cent of deliveries to the 25 principal customers to total deliveries	89%	93%	94%
Per cent of the 25 principal customers to total number of customers	30%	39%	36%
Deliveries to the 10 principal customers (in tons)	250,114	283,134	290,277
Per cent of deliveries to the 10 principal customers to total deliveries	71%	76%	80%
Per cent of the 10 principal customers to total number of customers	12%	16%	14%

* * *

During the years 1954, 1955 and 1956, Kennecott supplied to two independent fabricators, Revere Copper & Brass and General Cable, a combined annual average of about 87,000 tons of copper.

22. (a) In 1906, American Smelting and Refining Company (hereinafter referred to as Asarco) constructed a smelter a few miles from the Bingham Mine of Kennecott in Utah, under a contract by which it smelted the entire output of the Binghham Mine for compensation which was specified in the contract. This arrangement continued in effect until January 1, 1933. This smelter was known as the Garfield smelter.

(b) On January 1, 1933, a new contract called the "Utah Contract" went into effect which gave Asarco the right both to smelt and to refine the entire product of the Bingham Mine. As the Garfield smelter was not a refinery, the refining of the product occurred at Asarco refineries elsewhere, notably in Maryland and New Jersey.

(c) On November 29, 1940, a new contract was entered into between Kennecott and American Smelting and Refining Company. This contract, the "new Utah Contract," took effect January 1, 1943 and continued the right of Asarco both to smelt and to refine the entire product of the Bingham Mine. Under this contract, the refining of the product occurred at Asarco refineries in the States of Maryland, New Jersey and Washington.

(d) Under the "steptoe Contract," dated June 26, 1923 and effective August 1, 1923, Asarco had the right to refine all the Nevada Mine product. As Asarco did not have a refinery in Nevada, this refining was ordinarily done at Asarco's refineries in Maryland, New Jersey and Washington. The Nevada Mine smelted its own product.

(e) Under the "Ray/Chino Contract," dated April 23, 1927 an deffective as of January 1, 1927, Asarco smelted and refined all the product of the Ray Mine and the Chino Mine; its refineries were located in Maryland, New Jersey and Washington. By Agreement dated January 1, 1939, this contract was amended to permit Kennecott, itself, to smelt Chino concentrates and deliver Chino blister copper to an Asarco refinery if Kennecott wished to have it electrolytically refined. Under the "New Ray Contract," dated and effective as of October 1, 1940, the Ray product continued to be smelted and refined by Asarco.

(f) On July 29, 1948, the new Utah Contract was amended to permit Kennecott to build and operate a refinery of its own in Utah, capable of refining 16,000 tons of blister copper per month. Such a refinery was built near the Garfield smelter and became operative at the end of 1951, but since the production of the Utah and Nevada Mines usually exceeded 16,000 tons per month, some product from those mines continued to be refined by Asarco.

Substantially all other electrolytic refining continued to be done by Asarco since the Amendment also provided that product from the Nevada, Ray and Chino mines which Kennecott desires to so refine shall be refined at Asarco's Baltimore, Perth Amboy or Tacoma refineries.

• • •

(j) Kennecott and Asarco each owned 50 percent of the Garfield Chemical and Manufacturing Co., a producer of a by-product sulphuric acid located at the Utah smelter, until by purchase contract dated February 6, 1964, Kennecott acquired 100% ownership of the chemical company.

• • •

(l) Neither Kennecott nor its subsidiaries have owned stock in Asarco. Asarco has owned stock in Kennecott during the taxable years involved and thereafter but such ownership has been only about 1% of the total shares issued by Kennecott. Asarco has never owned stock in the Kennecott subsidiaries herein involved. In the taxable years involved, for many years prior and continuously since, the stock of both Kennecott and Asarco has been listed and actively traded on the New York Stock Exchange .Each corporation is and has been publicly owned.

23. The Franchise Tax Board determined that Chase was engaged in a unitary business with Kennecott, Kennecott Wire, Kennecott Sales, Braden and Bear Creek. The assessment against Chase was computed accordingly.

• • •

27. In computing the California portion of the unitary income, the Franchise Tax Board used the usual three-factor formula of property, payroll and sales. The Board did not employ a "production factor" composed of the expenses of mining and manufacturing in its formula. Since all the mining and manufacturing occurred outside California, such a "production factor" would be 0% for California for each of the years here involved.

• • •

30. No assets of any nature were owned jointly and no company leased space or property to another; however, Bear Creek and Kennecott Sales shared facilities at Kennecott's headquarters in New York.

31. No consolidated federal or state tax returns were filed.

• • •

35. For the years 1954, 1955 and 1956, Kennecott Wire paid to the State of Rhode Island tax on its entire corporate net income as net income is defined by Rhode Island law, and Rhode Island did not allocate any part of said Kennecott Wire net income to other states.

For the years 1954, 1955 and 1956, Kennecott Sales paid to the State of New York tax on its entire corporate net income as net income is defined by New York law, and New York did not allocate any part of said Kennecott Sales net income to other states.

• • •

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Appendix G

Opinions of Certified Public Accountants

1954

Chase Brass & Copper Co., Incorporated and Wholly-owned Subsidiaries

In our opinion, the statements herewith and the foregoing comments present fairly the financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries as at December 31, 1954 and the results of their operations for the year ended on that date, in conformity with generally accepted accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

Respectfully yours,

/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

1955

Chase Brass & Copper Co., Incorporated,
Waterbury, Connecticut.

May 1, 1956.

Gentlemen:

We have made an examination of the accounts of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries for the year ended December 31, 1955 and submit herewith the Consolidated Balance Sheet and related Statements of Income and Surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Consolidated Balance Sheet and Statements of Income and Surplus present fairly

the consolidated financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries at December 31, 1955 and the results of their operations for the year then ended, in conformity with generally accepted accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

There are also submitted a Schedule noted on the Index herewith and our comments, which present explanatory and analytical data based on information obtained from the accounts and records of the Company and as furnished to us by officers and employes.

Respectfully yours,
/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

1956

Chase Brass & Copper Co., Incorporated,
Waterbury, Connecticut.

April 30, 1957.

Gentlemen:

We have made an examination of the accounts of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries for the year ended December 31, 1956 and submit herewith the Consolidated Balance Sheet and related Statements of Income and Surplus for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying Consolidated Balance Sheet and Statements of Income and Surplus present fairly the consolidated financial position of Chase Brass & Copper Co., Incorporated and its wholly-owned subsidiaries at December 31, 1956 and the results of their operations for the year then ended, in conformity with generally accepted

accounting principles applied, in all material respects, on a basis consistent with that of the preceding year.

There are also submitted a Schedule noted on the Index herewith and our comments, which present explanatory and analytical data based on information obtained from the accounts and records of the Company and as furnished to us by officers and employes.

Respectfully yours,

/s/ LOOMIS, SUFFERN & FERNALD.
Certified Public Accountants.

Appendix H

When the Franchise Tax Board combines several corporations into one "unitary group", and applies its formulary allocation methodology as it has in this case, algebraically the allocation methodology proceeds through two steps. The board usually uses a short form of calculating the result which tends to obscure the fact that two steps are being taken. Here we prove algebraically (in Part A below), and then demonstrate arithmetically (in Part B below), the presence and the result of the two steps in the case at bar. Finally, we compute, year by year, the re-determination by formula of Chase's net income (in Part C below).

The first step is to apportion a part of the group's combined income to each corporation included in the combined group, not on the basis of the established accounting principles ordinarly used in determining an independent corporation's net income, but on the basis of a formula which assumes that each corporation earns the same in proportion to property, payroll and sales.

The second step is to allocate to California a part of the income apportioned to each corporation in the first step.

A. ALGEBRAIC PROOF.

Why the two steps are implicit in the board's methodology is shown algebraically as follows. (To keep the proof from becoming unwieldly only the sales factor will be used; the relationship set out is true whether one or more equally weighted factors are used, and is independent of of their number.)

The board's formula for determining Chase's California income is as follows (See, Stip., Exh. P):

$$(1)\quad \frac{\text{Chase's California sales}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \text{Chase's California income}$$

The first fraction in expression (1) is the board's sales factor. It compresses two steps into one, thus:

$$(2)\quad \left\{ \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \right\} = \frac{\text{Chase's California sales}}{\text{Group's sales everywhere}}$$

By substituting the left half of expression (2) into expression (1) where the board's sales factor appears, we can rewrite expression (1) as follows:

$$(3)\quad \left\{ \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \right\} \times \text{Group's combined income} = \text{Chase's California income}$$

But the standard statutory formula for determining the California income for a single corporation is as follows (this is the method Chase used in its California tax returns and which we insist is proper):

$$(4)\quad \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \text{Chase's total income} = \text{Chase's California income}$$

Upon comparing expression (4) with expression (3), we find that the left half of both expressions is equal to the same thing, Chase's California income. It therefore follows that the left halves of both expressions are equal to each other. Writing this out, we can cancel common fractions on opposite sides of the equal sign, as follows:

$$(5)\quad \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \frac{\text{Chase's California sales}}{\text{Chase's sales everywhere}} \times \text{Chase's total income}$$

Hence, expression (5) rewritten proves that the board's formula necessarily redetermines Chase's corporate net income:

$$(6)\quad \frac{\text{Chase's sales everywhere}}{\text{Group's sales everywhere}} \times \text{Group's combined income} = \text{Chase's total income}$$

The foregoing proof is, perhaps, a proof of the obvious. Nevertheless, we feel compelled to make it, for it is the essence of our disagreement with the California taxing agency. In short, expression (5) shows how the board has used its formula to redetermine Chase's total corporate net income. We used expression (4) to determine Chase's California net income. We object to the use of expression (5) to determine Chase's corporate net income, which is easily ascertained by reference to the independent marketplace where its income and expenses are readily identified.

B. ARITHMETIC DEMONSTRATION.

We now demonstrate arithmetically how the board has redetermined Chase's corporate net income. We select Chase's income year 1956 for our demonstration.

For purposes of the demonstration, we assume the most favorable resolution possible (for the taxpayer) of the issues the Court of Appeal remanded to the trial court.*

We have assumed that the net income from Kennecott's gold, silver and molybdenum is as shown in Plaintiff's Exhibit 2 in the trial court. We have assumed that Kennecott's mines will be put in the denominator of the property factor at the largest possible amount, their fair market value as found by the trial court. Of course, Braden and Bear Creek are eliminated from the consolidation.

The board's determination, as thus adjusted for the Court of Appeal's holding, is as follows (the figures are from Exhibit P to the Stipulation of Facts):

Allocation formula:			
Chase's California property	$ 1,896,827		
Group's property everywhere	$694,650,011	=	.0027306
Chase's California payroll	$ 245,658		
Group's payroll everywhere	$106,087,571	=	.0023156
Chase's California sales	$ 10,422,917		
Group's sales everywhere	$440,358,141	=	.0236692
Total			.0287154
Average			.0095718
Unitary net income of group	$117,913,865		
Chase's California net income (multiply $117,913,865 by .0095718)	$ 1,128,647.93		

Using the board's formula as we have rewritten it in expression (3) in part A above, we enter into the formula the dollar amounts used by the board's auditor in his workpapers (Stip., Exh. P), as adjusted for the Court of Appeal's holding. Chase's California sales are $10,422,917; Chase's sales everywhere are $201,302,912; the group's sales everywhere are $440,358,141; and the group's combined

*There is one remanded issue that our calculations do not assume will be decided in favor of the taxpayer. The issue is whether the three factor formula should be expanded to include a fourth factor. The California numerator of this fourth factor, expenses of manufacture, would be zero since Chase does no manufacturing in California. Hence, the California tax would be reduced by 25 percent if that factor were added, thus reducing the multiplication of Chase's tax approved below from seven-fold to five-fold.

income is $117,913,865. (The parentheses are used below to indicate the redetermination of corporate net income.)

$$\frac{10,422,917}{201,302,912} \times \left\{\frac{201,302,912}{440,358,141} \times 117,913,865\right\} =$$
$$.0517773 \times (.4571345 \times 117,913,865) =$$
$$.0517773 \times (53,902,495.72) = 2,790,925.69$$

We next go through the same calculations for the payroll factor:

$$\frac{245,658}{37,502,669} \times \left\{\frac{37,502,669}{106,087,571} \times 117,913,865\right\} =$$
$$.0065504 \times (.3535067 \times 117,913,865) =$$
$$.0065504 \times (41,683,341.30) = 273,042.56$$

And, finally, for the property factor:

$$\frac{1,896,827}{61,610,028} \times \left\{\frac{61,610,028}{694,650,011} \times 117,913,865\right\} =$$
$$.0307876 \times (.0886922 \times 117,913,865) =$$
$$.0307876 \times (10,458,040.10) = 321,977.96$$

The foregoing calculations reveal two sets of significant figures. These may be summarized as follows:

(1) Factor	(2) Chase's corporate net income as reallocated by each factor in column (1)	(3) Chase's California income as determined by each factor in column (1)
Sales	$ 53,902,495.72	$2,790,925.69
Payroll	41,683,341.30	273,042.56
Property	10,458,040.10	321,977.96
Totals	$106,043,877.12	3,385,946.21
Totals divided by three	$ 35,347,959.04	$1,128,648.74

Because each factor is an equally weighted one-third of the total allocation formula, we must divide each of the totals above by three to reach the ultimate results obtained by the board. Doing so, we have found Chase's corporate net income (column 2) to be $35,347,959.04, and Chase's California income (column 3) to be $1,128,648.74.

Compare Chase's corporate net income calculated here with the amount shown in line 1, column 4 of Schedule 6 in part C below. The amounts are identical.

Compare Chase's California income calculated here with the result obtained by following the board's methodology above. Again the amounts are identical.

Hence, we have demonstrated both algebraically and arithmetically that appellant's formula reallocates Chase's corporate net income, but in the guise of geographical allocation. It is not true, as the board argued below, that its formulary methodology does not have implicit in it a redetermination of corporate net incomes.

C. THE GROUP'S REDETERMINED NET INCOME.

Following the methodology demonstrated in parts A and B above, it is possible to develop for each corporation a corporate property, payroll and sales factor. The numerator of the fraction is the corporation's property, payroll or sales, while the denominator is the total of the "unitary" group's property, payroll or sales. These factors are developed in Schedules 1, 3 and 5 for the income years 1954, 1955 and 1956, respectively. The source of the data is Exhibit P attached to the Stipulation of Facts, which is the board's auditor's work papers in which the deficiency assessment is computed. This data has been adjusted to reflect the holding of the Court of Appeal.

For example, in Schedule 1, line 1, column 1, Chase's corporate property factor is set out. The numerator of the factor is $52,134,505, which is the amount of Chase's property everywhere as shown in line 1, column 1, Schedule II, Exhibit P. The denominator of the factor is $699,559,428, which is the total of the group's property everywhere as adjusted from line 6, column 1, Schedule II, Exhibit P. On the next line in column 1 of Schedule 1, the decimal equivalent of the fraction is set out. Similarly, Chase's

other factors and those of the other corporations are developed in Schedules 1, 3 and 5. In column 4 of these three schedules are shown the corporate income reallocation factors, which are calculated by summing columns 1, 2 and 3 and then dividing by three.

In column 4 of Schedules 2, 4 and 6, for the income years 1954, 1955 and 1956, respectively, are shown the amounts of corporate net income the formula reallocates to each corporation. These net incomes are calculated by multiplying the corporate allocation factors from column 4 of Schedules 1, 3 and 5 (which are also set out in column 3 of Schedules 2, 4 and 6) by the group's total net income (from Exhibit P, Schedules IA, IB and IC). The product is the reallocated corporate net income.

Columns 3 and 4 of Schedules 2, 4 and 6 may be compared with columns 1 and 2 which reflect the corporate net income actually earned by each corporation (from Exhibit P, Schedules IA, IB and IC). Column 1 shows the amount of net income actually earned and column 2 shows what percentage it is of the group's total net income. Finally, column 5 shows the board's reallocated net income as a percentage of the net income that each corporation actually earned in the marketplace.

For example, in the first line of Schedule 2, for the income year 1954, Chase earned $7,871,558 (column 1) or 12.97% of the group's total (column 2). The formula, however, attributes over 32% of the group's total to Chase (column 3), in the amount of $19,818,721 (column 4), for an increase of 252% (column 5).

SCHEDULE 1

INCOME YEAR 1954

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	52,134,505	36,159,453	159,564,138	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.0745248	.4174861	.4875918	32.65342%
Kennecott Wire	3,622,708	2,012,468	4,497,422	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.0051786	.0232353	.0137431	1.40523
Kennecott	643,802,215	48,440,426	163,187,885	
	699,559,428	86,612,347	327,249,445	
	or	or	or	
	.9202967	.5592785	.4986651	65.94135

SCHEDULE 2

INCOME YEAR 1954

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 1%	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase	$ 7,871,558	12.97%	32.65342%	$19,818,721	252%
Kennecott Wire	1,782,128	2.94	1.40523	852,893	48
Kennecott	50,689,329	83.51	65.94135	40,022,551	79
Kennecott Sales	351,150	0.58	—	—	—
Totals	$60,694,165	100.00%	100.00 %	$60,694,165	

SCHEDULE 3

INCOME YEAR 1955

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	48,914,498	39,599,287	199,430,936	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.0716090	.4162428	.4776925	32.18481%
Kennecott Wire	3,672,483	2,162,430	5,395,073	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.0053764	.0227301	.0129227	1.36764
Kennecott	630,490,340	53,373,362	212,662,106	
	683,077,321	95,135,079	417,488,115	
	or	or	or	
	.9230146	.5610272	.5093848	66.44755

SCHEDULE 4

INCOME YEAR 1955

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 3	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase (loss)	($ 1,380,516)	—	32.18481%	$ 33,102,597	—
Kennecott Wire	2,660,518	2.59%	1.36764	1,406,640	53%
Kennecott	101,476,492	98.66	66.44755	68,342,377	67
Kennecott Sales	95,120	.09	—	—	—
Totals	$102,851,614		100.00%	$102,851,614	

SCHEDULE 5

INCOME YEAR 1956

Corporation	(1) Property Factor	(2) Payroll Factor	(3) Sales Factor	(4) Board's Formulary Percent: Average of Columns 1, 2 and 3
Chase	61,610,028	37,502,669	201,302,912	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.0886922	.3535067	.4571345	29.97778%
Kennecott Wire	3,769,676	2,659,693	4,924,993	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.0054267	.0250707	.0111841	1.38938
Kennecott	629,270,307	65,925,209	234,130,236	
	694,650,011	106,087,571	440,358,141	
	or	or	or	
	.9058811	.6214226	.5316814	68.63284

SCHEDULE 6

INCOME YEAR 1956

Corporation	(1) Corporate Net Income Per Books	(2) Column 1 as Percent of Group's Total Net Income	(3) Percentage Per Board's Formula—Schedule 5	(4) Net Income Per Board's Formula	(5) Column 4 as Percent of Column 1
Chase	$ 5,106,554	4.33%	29.97778%	$ 35,347,959	692%
Kennecott Wire	4,536,969	3.85	1.38938	1,638,272	36
Kennecott	108,247,408	91.80	68.63284	80,927,634	75
Kennecott Sales	22,934	0.02	—	—	—
Totals	$117,913,865	100.00%	100.00 %	$117,913,865	

Appendix I

It is an economic fact that since World War II in this country the mining of non-ferrous metal has been far more profitable than its fabrication. This Court may take judicial notice of economic fact. An examination of industry statistics set forth in *The Value Line Investment Survey,* (December 6, 1968) pp. 940-1058, demonstrates the economic fact that mining is more profitable than fabrication. For the years before the Court, the following table shows the percentage of net profit to sales, as set out in *Value Line,* for mining companies, for companies that both mine and fabricate, and for companies that fabricate:

1954-1956 Profitability Comparisons*

	Percent of Profit to Sales				
	1954	1955	1956	Average	Major Products
1. Mining Companies					
American Zinc	7.5	9.3	10.4	9.1	zinc
Campbell Red Lake	53.5	57.4	56.4	55.8	gold
Cerro Corp.	28.8	34.3	19.1	27.4	lead, zinc, copper, gold
Cominco Ltd.	38.0	40.4	39.9	39.4	lead, zinc
Foote Mineral Co.	24.2	24.2	25.3	24.6	manganese, lithium
Hecla Mining Co.	.....	.....	50.9	50.9	lead, zinc, silver
Homestake Mining	32.2	27.7	28.6	29.5	gold
Hudson Bay Mining	44.5	53.2	52.0	48.9	copper, zinc, gold, silver
Inspiration Consol. Copper	41.4	49.0	47.3	45.9	copper
International Nickel	37.2	43.4	40.6	40.4	nickel, copper, other
Kennecott Copper	34.3	50.2	51.8	45.4	copper, other
Magma Copper	33.3	37.2	35.1	35.2	copper
Molybdenum Corp.	9.6	10.7	10.4	10.2	molybdenum, rare earth
St. Joseph Lead	14.5	16.8	14.1	15.1	lead, zinc
Average	30.1	34.9	34.4	34.1	
2. Mining and Fabricating Companies					
Anaconda	17.5	30.5	33.3	27.1	copper, zinc
Copper Range Co.	10.1	34.6	37.0	27.2	copper
Phelps Dodge Corp.	28.1	37.8	37.8	34.6	copper
Average	18.5	34.3	36.0	29.6	
3. Fabricating Companies					
Revere Copper & Brass	13.3	10.9	8.7	10.9	brass mill
Continental Copper	8.3	9.1	13.5	10.3	wire mill
General Cable Corp.	12.4	11.0	14.1	12.5	wire mill
Fansteel Metallurgical	12.0	19.8	24.7	18.8	refractory metals
International Silver	12.1	11.1	9.7	11.0	silver
Average	11.6	12.4	14.1	12.7	

*The information in the above tables was compiled by *Value Line* from consolidated financial statements prepared by the companies in compliance with stock exchange rules. Accordingly, whether mining companies with fabricating subsidiaries are shown in group 1 or 2 depends on the extent of the company's mine production fabricated by the company's fabricating subsidiaries. Kennecott thus appears in the group of mining companies, while Phelps Dodge and Aanaconda appear in the group of mining and fabricating companies.

The table clearly shows that mining is more profitable than fabricating. The average percent of net profit to sales for predominantly mining companies is 34.1%. The average percent of net profit to sales for companies that mine and fabricate drops to 29.6%. Finally, the average percent of net profit to sales for companies that simply fabricate drops to 12.7%. *Value Line* shows the percent of net profit to sales for all the foregoing companies for the years 1952 to 1967. A presentation of those percentages is unnecessarily cumbersome, but the same relationships do appear. Mining tends to be more than twice as profitable as fabricating. It is revealing to note that, for those companies which both mine and fabricate, the fabricating operation pulls the company's over-all profit percentage down from the high mining profit percentage to a percentage closer to the lower fabricating profit percentage.